MARKET PERFORMANCE AND COMMENTARY – JUNE 2020

MARKET PERFORMANCE

Index	Index Level/ Price	1 Month %	3 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.
Global Equities						
MSCI Emerging Markets	590.58	6.6	16.7	1.4	4.5	5.1
MSCI All Country World Index	254.78	2.9	18.3	3.1	6.6	6.9
S&P 500 (US)	3,100.29	1.8	20.0	5.4	8.6	8.5
Nikkei 225 (Japan)	22,288.14	1.9	17.8	4.8	3.6	2.0
FTSE 100 (UK)	6,169.74	1.5	8.8	-16.9	-5.5	-1.1
DAX (Germany)	12,310.93	6.2	23.9	-0.7	0.0	2.4
CAC 40 (France)	4,935.99	5.1	12.3	-10.9	-1.2	0.6
Trans-Tasman Equities						
S&P/NZX 50	11,451.05	5.2	16.9	9.0	14.6	14.9
S&P/ASX 300	64,102.05	2.4	16.8	-7.6	5.2	6.0
Bonds						
Bloomberg NZBond Govt NZD	4,586.29	-0.6	2.2	5.7	6.0	5.2
Bloomberg NZBond Composite NZD	1,656.87	-0.3	2.4	5.4	5.6	5.0
BBgBarc Global Aggregate Hdg NZD	440.20	0.5	2.4	5.7	5.0	5.2
FTSE WGBI Hdg NZD	3,711.45	0.3	1.1	6.6	5.5	5.4
Oil						
West Texas Intermediate Crude	37.26	8.7	23.5	-56.6	-18.4	-23.5
Brent Crude	41.15	16.5	81.0	-38.2	-5.0	-8.3
NZD Foreign Exchange						
AUD	0.9345	0.0	-3.9	-1.6	-2.2	3.2
EUR	0.5724	2.5	4.7	-2.0	-11.0	-8.1
GBP	0.5143	4.0	5.2	-1.2	-8.9	14.5
JPY	69.33	6.3	6.6	-2.7	-13.5	-19.8
CNY	4.5676	5.7	7.7	0.3	-7.1	5.3
USD	0.6446	5.9	6.6	-2.3	-10.8	-7.8

Source: Morningstar, RBNZ

We make the following key observations:

- Double digit returns of equity markets over the three-month period in the bounce back.
- Positive NZX50 performance over all time horizons.
- Relatively consistent returns from bond markets over longer time horizons but shorter term volatility.
- Oil price back to around $40.
- Weakness of the NZD against the AUD over all periods except 5 years.

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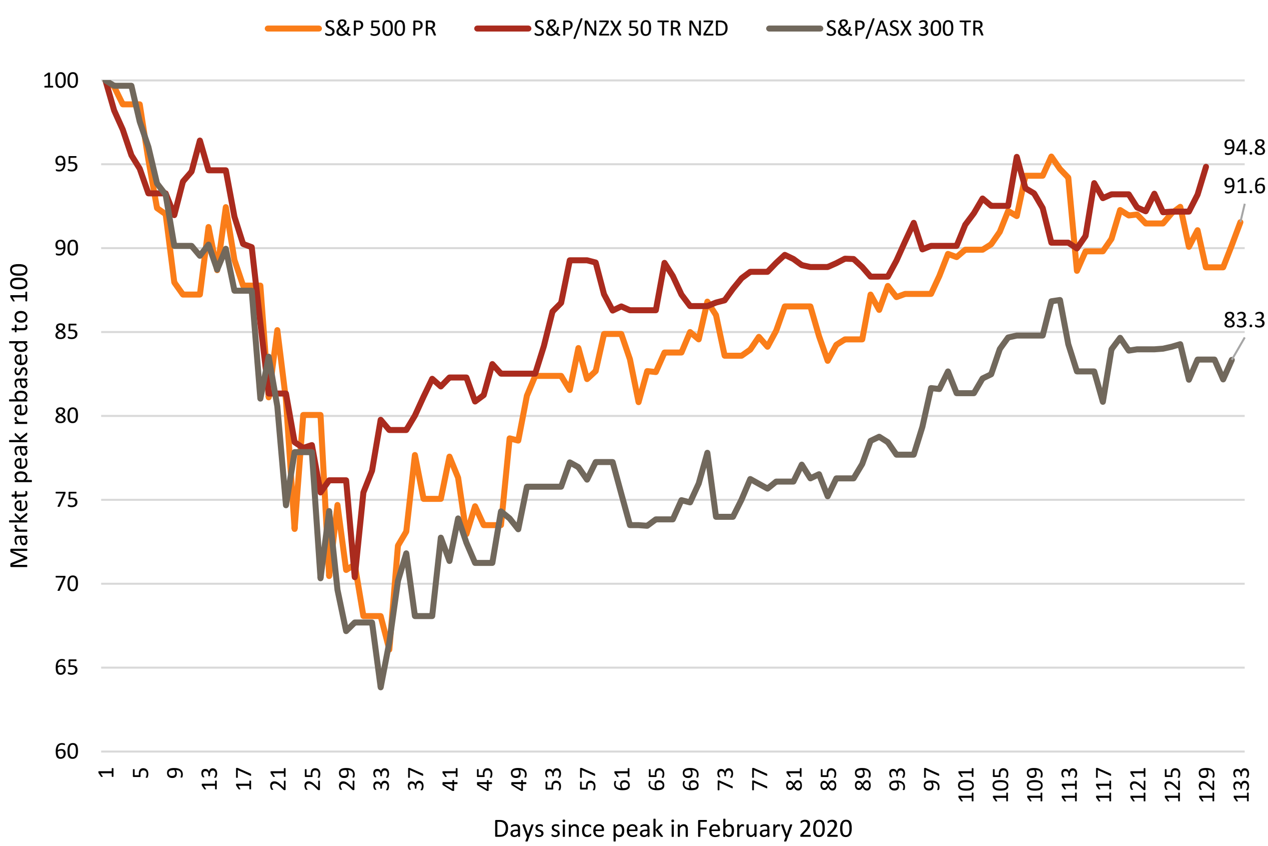
ECONOMIC COMMENTARY

There is the tendency for investors to overweight factors that are more vivid in their memory. It is important not to expect recent events/trends to continue into the future. Will we experience another confluence of events like that in February and March? What has caused the rebound in equity markets and will it continue? (see **Figure 1**)

Figure 1: Rebound in equity markets from February peak to 30 June 2020



Source: data from Morningstar Direct

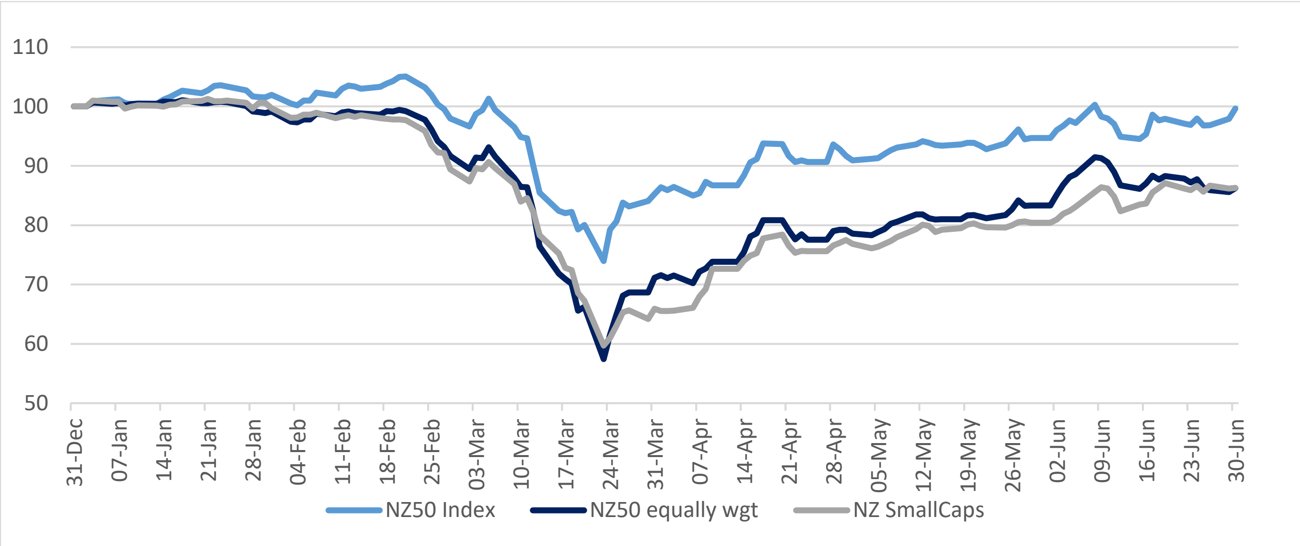
The rise in markets since March has surprised many risk averse investors. We think the following factors have contributed to this surge: central bank intervention creating liquidity and pushing interest rates down to record lows, reopening of economies, the hope of a vaccine in the foreseeable future, fiscal support and retail investor confidence or complacency.

Economic uncertainty due to the large-scale job losses and increasing geopolitical risks should temper investor optimism. The election in the US in November increases the trade and military tensions with China. September's election in New Zealand is also coming up fast. The outcome of both of them should have a significant impact on their respective financial markets.

The NZX50 returned 5.2% in June. The two largest companies, A2 Milk and Fisher and Paykel Healthcare, make up over a quarter of the market cap-weighted index and drove returns with respective performances of 6.3% and 18.8%. To have any chance of beating the market in recent times you would've needed to concentrate your New Zealand equities towards these two stocks.

To illustrate this point using the return of the market in the first half of 2020, **Figure 2** compares how far the New Zealand equity market fell if the stocks are equally weighted (dark blue line) versus market capitalisation weighted (light blue line).

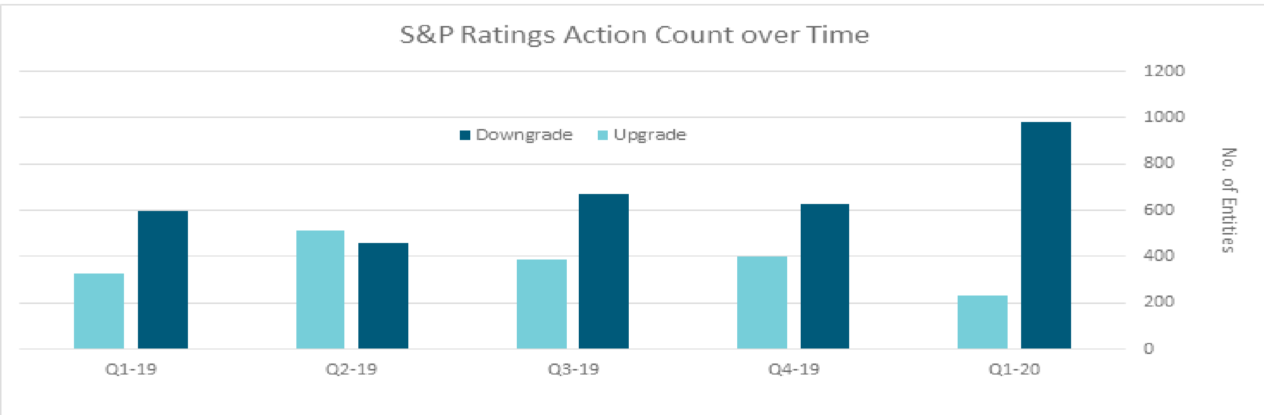
Figure 2: New Zealand equity market performance H1 2020



Source: Aspiring Asset Management

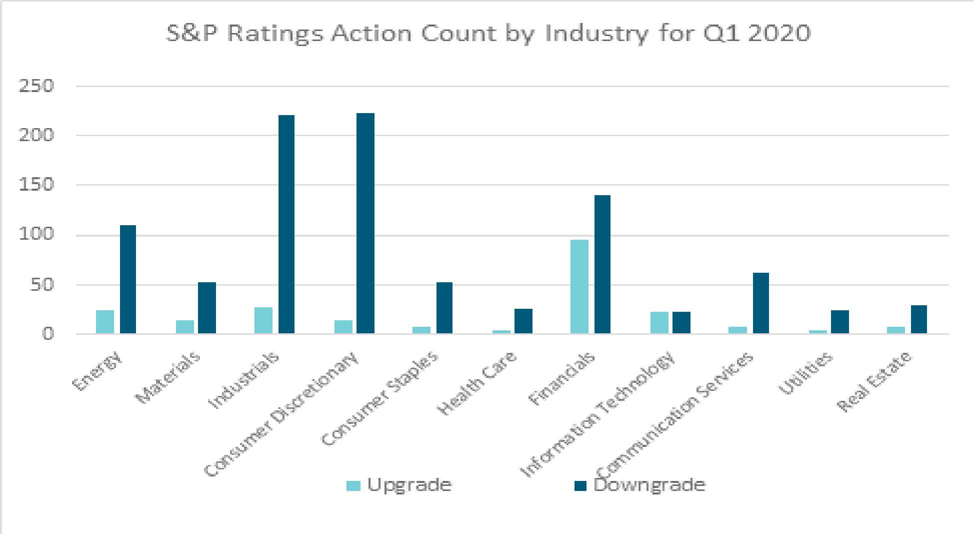
Looking down the track, the factors driving markets (mentioned above) need to be weighed up with business fundamentals like company earnings, functioning supply chains, access to credit, and ultimately the risk of solvency. **Figures 3 and 4** indicate changes to credit ratings so far. The S&P credit rating actions show a broad increase in credit risk in the first quarter of 2020 with almost a thousand downgrades to credit ratings, compared to just over two hundred upgrades. The sectors most affected were industrials and consumer discretionary, and less so within energy and financials.

Figure 3: Changes to S&P credit ratings over time



Source: Harbour Asset Management

Figure 4: Number of S&P credit changes by sector



Source: Harbour Asset Management

The OCR remained on hold at 0.25% in June as expected. Economic risks remain to the downside and the RBNZ is ready to increase the Large Scale Asset Purchase (LSAP) programme if necessary. This will continue to support asset prices. On the other hand, if the LSAP programme isn't increased or maintained, it indicates that things aren't as bad as we thought in the economy. This could (counter-intuitively) see less support for asset prices in the near term.

The equivalent market operations by the Federal Reserve in the US will also continue to keep interest rates low. Fed Chair, Jerome Powell, spoke before the US House of Representatives at the end of June. He reinforced their commitment to use the full range of tools available to them to support the economy and help assure the House of as robust a recovery as possible. **Figure 5** illustrates how low interest rates are around the globe at present.

Any future returns will be a challenge to achieve with any real certainty given the many risks to the downside. We think investors should err on the side of caution.

Figure 5: 10 Year Government Bond Yields vs 2-Year Swap Yields