MARKET PERFORMANCE AND COMMENTARY – DECEMBER 2020

MARKET PERFORMANCE

Index	Index Level/ Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI Emerging Markets	744.41	6.1	16.0	19.1
S&P 500 (US)	3756.07	3.7	11.7	16.3
Nikkei 225 (Japan)	27444.17	3.8	18.4	16.0
FTSE 100 (UK)	6460.52	3.1	10.1	-14.3
DAX (Germany)	13718.78	3.2	7.5	3.5
CAC 40 (France)	5551.41	0.6	15.6	-7.1
Trans-Tasman Equities				
S&P/NZX 50	13091.64	2.5	11.4	13.9
S&P/ASX 300	72901.02	1.3	13.8	1.7
Bonds				
S&P/NZX NZ Govt Stock	1933.54	-0.9	-2.8	5.4
S&P/NZX A Grade Corporate	5970.97	-0.3	-1.0	5.4
BBgBarc Global Aggregate Hdg NZD	431.18	0.3	0.8	5.4
FTSE WGBI Hdg NZD	3746.90	0.1	0.2	6.1
Oil				
West Texas Intermediate Crude	48.52	7.0	20.6	-20.5
Brent Crude	51.17	8.5	25.0	-23.0
NZD Foreign Exchange				
AUD	0.9331	-2.2	1.2	-2.8
EUR	0.5885	0.2	4.4	-2.1
GBP	0.5267	0.1	3.0	3.4
JPY	74.3364	1.4	6.6	1.4
CNY	4.6776	1.2	4.3	-0.5
USD	0.7200	2.4	8.9	6.7

Source: Nikko

Executive summary:

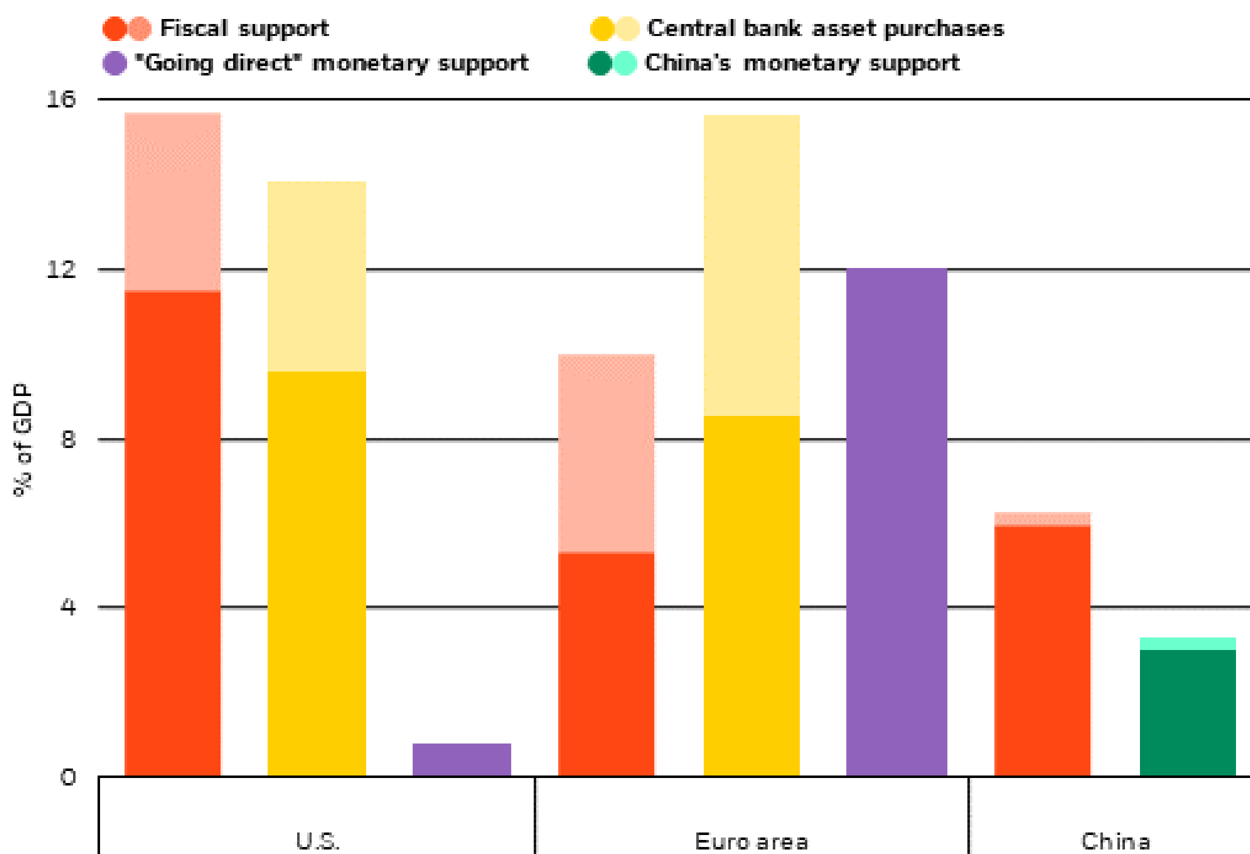
- Oil has almost recovered to pre COVID levels (about $60 per barrel)
- NZ dollar weakens against AUD, positive for unhedged returns
- Despite the pandemic crash, global equity markets (ex Europe & Australia) have risen strongly
- Bond markets drop reflecting the current unattractiveness of the asset class
- Watch for increasing interest rates and inflation

ECONOMIC COMMENTARY

GENERAL

Most assets are at extremely high, if not bubble-like prices because of the amount of quantitative easing both monetary by Central banks or fiscal by Governments trying to ease COVID disruptions on their citizens.

Estimated fiscal and monetary support in key economies, 2020 and 2021



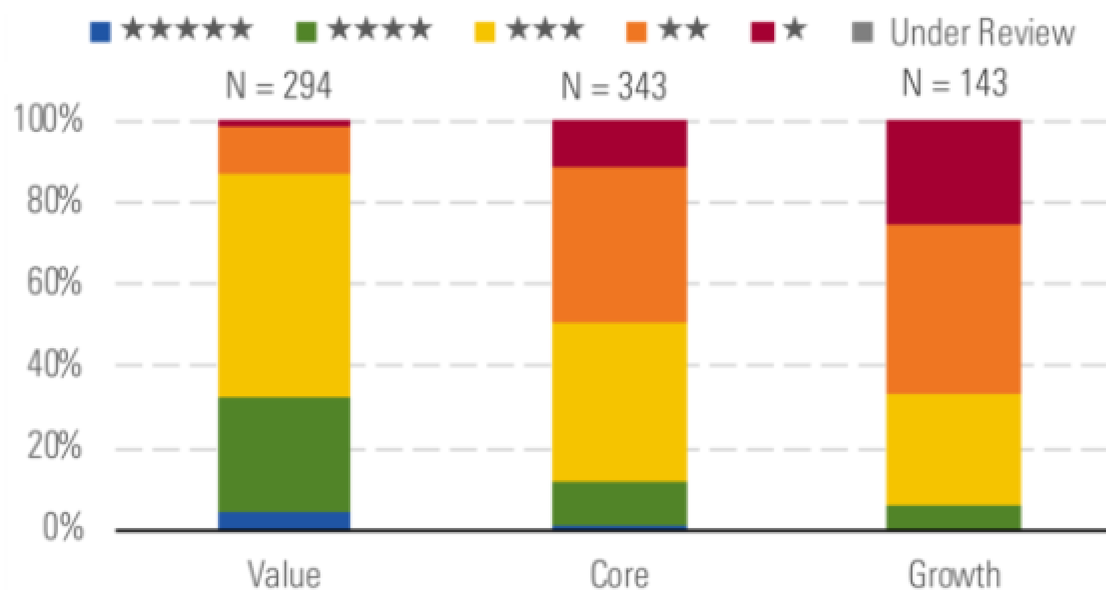
Source: BlackRock

FINANCIAL MARKETS

Markets followed the November trend with low volatility. Positive news coming from vaccine manufacturers and government support measures added to positive market sentiment. Bond yields continued to be low however they reached their highest levels in months with the benchmark 10-year US Treasury note reaching 0.93%. Equities continue to get more expensive.

Our view is that asset prices continue to be supported by a low interest rate environment. There has been murmur of the NZ OCR not going to further lows because local economic activity has been remarkably better than forecasts back in March. However, the generally low environment may remain for the foreseeable future which will support continued equity market rallies and general asset inflation.

There is potential for shift from growth to value because of the overpriced growth stocks have led to potentially under-priced value stocks. Growth investing has dominated the last decade due to low inflation, economic growth, and interest rates, coupled with significant performance of technology growth stocks. However, the shift will not be at the expense of growth, as passive and retail investors tend not to invest in value and they are a growing segment of the market.



Value stocks attractive compared with core and growth stocks - Morningstar

Source: MorningStar

Alternatively, value or dividend paying stocks could substitute low yielding high risk bonds as a safer investment for institutions. Normally, bonds are less risky and pay less than equities. However, our view is that bonds now are riskier than equities whilst continuing to pay less. With the combination of the US dollar weakening, probable inflation increasing in the next one to two years, the distortion of returns above the 'risk-free' rate will continue, resulting in asset prices continuing to be disproportionately higher than we expect. Until the bubble bursts perhaps?

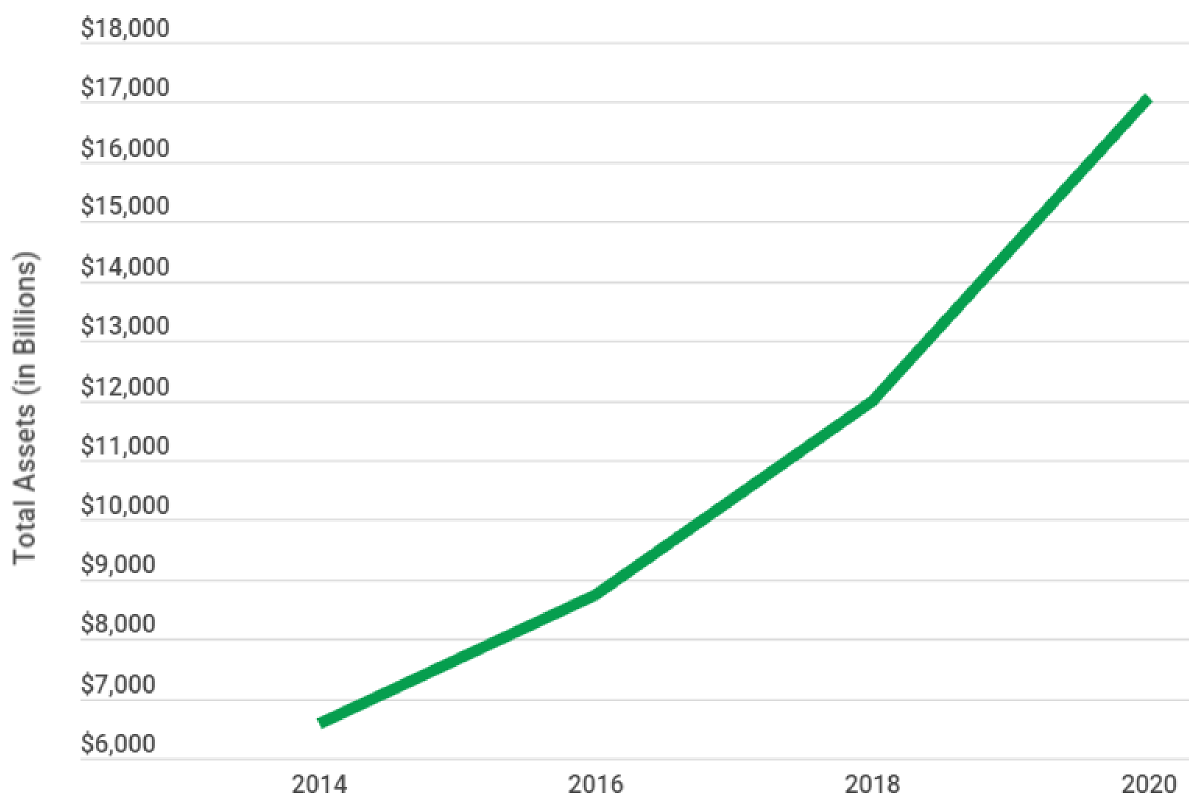
Other alternative investment spaces that Eriksens is recommending are:

- Private equity and private debt. Far less risky asset classes than they are given credit for because they are not as susceptible to listed market volatility.
- Dividend stocks including energy companies, provide more robust income sources compared to bonds.
- Insurance linked securities provide a nearly uncorrelated substitute to public markets yet provide traditional bond like returns.
- Sustainable investment managers and funds are more attractive than ever before as the financial market is recognising the importance that these investments provide the greater good of our society (and of course the added returns they are providing).

The importance of Environmental, Social and Governance investing has gained pace over the last few years and will be a key element for Eriksens and our clients this year. This theme is confirmed with the Biden

administration aiming to improve regulations for sustainable investing. The United States Forum for Sustainable and Responsible Investment reported that total US-domiciled assets under management employing ESG investing strategies increased 42 percent over the past two years, to $17 trillion in 2020 up from $12 trillion at the start of 2018. These numbers represent 33% of all US assets under professional management.

How we look to advise our clients' investment strategies is inextricably linked to their values and how we can reflect that in their portfolio. It is pleasing to see support for ESG on the biggest political stage, but not surprising given the increasing assets devoted to sustainable investing over the last six years.



Source: Forbes.com

GEOPOLITICAL

Geopolitical risks are high; however, US-China tensions are continuing with a recent ban of three Chinese telecom companies from trading on the NYSE. China and Australia relations are still strained with continuing tariffs imposed on Australian wines and low buying volumes for cotton, meat and coal.

The transition from Trump to Biden will continue to open the cracks and deep divisions among American people. The Republican party has become splintered and the long-term impacts of the Trump administration on democratic integrity will be felt for years to come. Compared to the Chinese who exude

stability over time, albeit with authoritarian means, will find a competitive advantage in the global marketplace.

With a blue wave win after successful Democrat wins in Georgia, Biden will have more ease to implement the changes he promised during the campaign. Albeit, he may start to feel pressure form the far left group of his party in Sanders and Ocasio-Cortez to introduce more socialist measures that could further divide the already broken nation. We hold that potential higher corporate tax rates would be a small headwind to financial markets but will not cause significant effect. Markets have responded well in January to the Democratic wins in Georgia.

The UK-EU post-BREXIT deal was treated as a Christmas gift but had been priced into the markets since the start of the year, whether or not a deal was to be made. The main outcome is that there will not be taxes or tariffs on the goods coming from the EU to the UK and vice versa, which dispelled the fear of more expensive life for the UK citizens.

SOCIAL UNREST

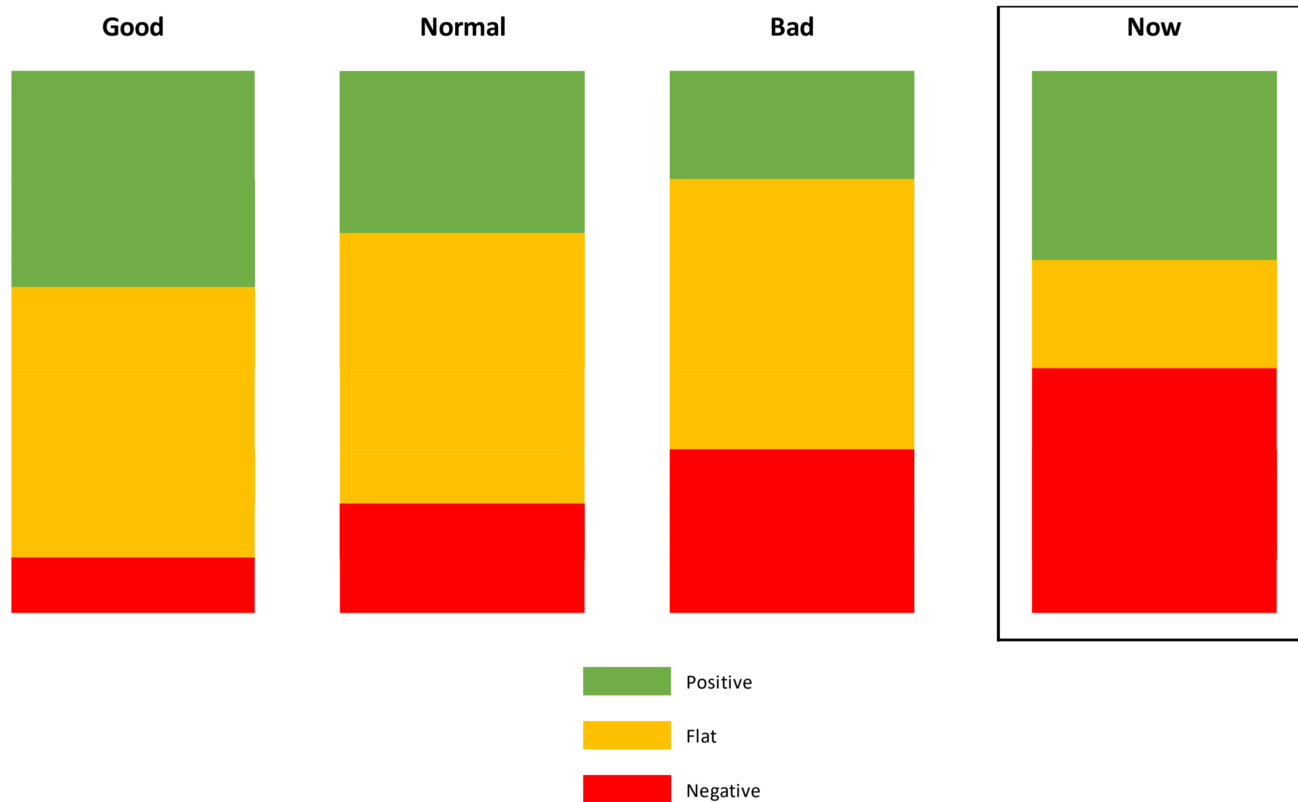
The US democracy appears to be teetering on the brink of a crisis. There is an evident move towards further political and social unrest in the US. Nobel winning economist, Paul Krugman, agrees with us that the US is on its way to being an oligarchy. With more families transferring wealth to those who have not earned it, we see this as a trend becoming more apparent over time. Since the low interest rate environment is here for the medium term, it will continue to support higher equity valuations and those who already have wealth invested prudently. In our view this widening of the gap between rich and poor is contributing to social tensions.

COVID-19 PROGRESS?

The current economic crisis is different from historic downturns. Usually, it is related to a bubble, debt, supply or commodity related shock, however the current economic pain came almost overnight as a result of a virus that is external to the economy. Our view is that the economic recovery is highly dependent on progress against the disease and interim fiscal expenditures.

New Zealand, compared to the rest of the world, has done a good job thus far in supporting these measures. However, with 2021 upon us and little progress seen overseas in public health responses, vaccine distribution and proven widespread immunity, we need to remain vigilant in our local virus response and understand what remaining economic tools we have left should a further March 2020 shock come again. We expect there will be a correction in 2021, but does more quantitative easing increase inflation risk to undo all our good work so far? Thank goodness we are not Grant Robertson. Our best economic tool is not financial, it is border control, distribution logistics and having open communication lines with our neighbouring countries.

MARKETS OUTLOOK



- A bigger probability of getting a good return…
- …But an even bigger chance of getting a negative or very low return.
- Unlikely that average returns will be made.