# MARKET PERFORMANCE AND COMMENTARY – APRIL 2021

## MARKET PERFORMANCE

| Index | Index Level/Price | 1 Month % | 3 Month % | 1 Year % |
|---|---|---|---|---|
| Global Equities | | | | |
| MSCI Emerging Markets | 786.33 | 1.6 | 1.8 | 42.9 |
| S&P 500 (US) | 4181.17 | 5.2 | 12.6 | 43.6 |
| Nikkei 225 (Japan) | 28812.63 | -1.3 | 4.2 | 42.7 |
| FTSE 100 (UK) | 6969.81 | 3.8 | 8.8 | 18.1 |
| DAX (Germany) | 15135.91 | 0.8 | 12.7 | 39.4 |
| CAC 40 (France) | 6269.48 | 3.3 | 16.1 | 37.1 |
| Trans-Tasman Equities | | | | |
| S&P/NZX 50 | 12731.13 | 1.4 | -3.0 | 20.9 |
| S&P/ASX 300 | 78734.22 | 3.7 | 7.6 | 31.6 |
| Bonds | | | | |
| S&P/NZX NZ Govt Stock | 1881.86 | 0.8 | -2.2 | -3.5 |
| S&P/NZX A Grade Corporate | 5875.66 | 0.5 | -1.3 | -0.1 |
| Barclays Global Agg (Hedged to NZD) | 421.55 | 0.3 | -1.7 | 0.1 |
| FTSE WGBI (Hedged to NZD) | 3631.91 | 0.0 | -2.3 | -2.0 |
| Oil | | | | |
| West Texas Intermediate Crude | 63.58 | 7.5 | 21.8 | 237.5 |
| Brent Crude | 66.53 | 6.6 | 21.3 | 180.7 |
| NZD Foreign Exchange | | | | |
| AUD | 0.9289 | 1.0 | -1.1 | -1.4 |
| EUR | 0.5960 | 0.0 | 0.5 | 5.8 |
| GBP | 0.5182 | 2.1 | -1.3 | 5.9 |
| JPY | 78.4264 | 1.3 | 3.9 | 18.9 |
| CNY | 4.6410 | 1.0 | 0.0 | 6.6 |
| USD | 0.7175 | 2.4 | -0.4 | 16.3 |

Source: Nikko

Executive summary:

- Stock markets resumed their upward momentum
- Yield curves flattened out slightly
- NZ dollar, oil and gold recouped the losses from the previous month



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# ECONOMIC COMMENTARY

## WORLD ECONOMIC OVERVIEW

"While the COVID-19 pandemic is first and foremost a health crisis, its implications are much more far-reaching." – António Guterres, Secretary-General of the United Nations, 9th April 2020. Indeed!

High uncertainty clouds the global economic outlook, primarily related to the path of the pandemic. The contraction of activity in 2020 was unprecedented in its speed and synchronized nature. But it could have been a lot worse. The IMF estimates the contraction could have been about three times greater without such extraordinary policy support. Governments have proved they can engineer growth in the short term, but how this plays out in the medium to long term remains to be seen.

New virus mutations and the accumulating human toll raises concern, even as growing vaccine coverage lifts sentiment in the West. The growing second waves in India and Brazil are a reminder of the devastation. There remains an uphill battle to beat the virus and avoid further divergence of income per capita across economies and mitigate income differences within countries. Many financial market assumptions are resting on a successful vaccine program being complete by the end of the year, continued low interest rates and friendly central bank support…

"It's not what you know that gets you in trouble, it's what you know for sure that just ain't true that will."- Mark Twain

On the vaccine front, the US has administered over 200 million doses, with about 40% of the population having had at least one shot. The main headwinds to herd immunity will be vaccine hesitancy. But in Europe the vaccine rollout has been beset by supply problems, as well as concerns about the rare side-effects of the AstraZeneca vaccine. Still, almost 28 million doses have been administered in the EU over the past fortnight, with almost 20% of the population now having received at least one dose.

## KEY ECONOMIES

***United States***

Earnings season in the US has been positive: 60% of the S&P 500 reported results for Q1 2021 (as at 30 April 2021) and 86% of them reported earnings per share above estimates – north of the five-year average (74%).

US GDP growth was +6.4% for Q1 which was 0.3% below consensus estimates. This was partly due to lower-than-expected inventories, higher imports, and lower exports. Also, Pending Home Sales for March came in 2.5% below expectations due to limited housing supply, which has become an ongoing issue over the past few months. All time high lumber prices are a testament to the supply – demand imbalance, with Lumber futures +42% MTD, +63% YTD, and +344% over the past year.

***China***

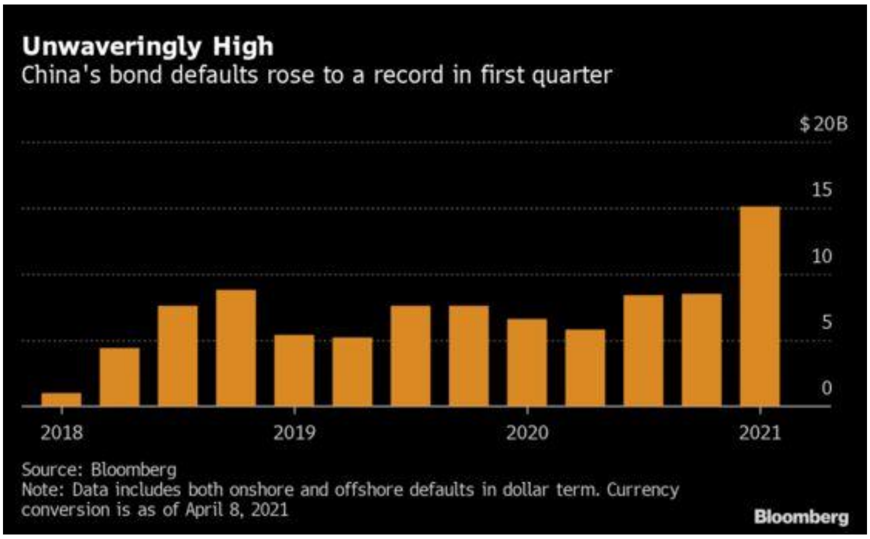
China's GDP grew a record 18.3% in the March quarter year on year. This looks remarkable, but the result was cycling out the last March quarter when China was in lockdown. It needs to be remembered that Q1

2020 saw a record -6.8% contraction. Between the December and March quarters, China's economy contracted -0.6%.

This goes hand in hand with their corporate debt struggles, where loose financial disclosure rules and creative reporting is common. Foreign buying on Chinese government bonds has stalled, and Chinese companies defaulted on 74.75 billion yuan ($11.4 billion) of local notes during the first three months of 2021, which is more than double the previous record set last year.

Real estate firms made up 27% last quarter's record $15.1 billion of missed payments for onshore and offshore bonds, according to Bloomberg. With interest rates trending up generally, how the Chinese debt markets cope will be interesting to watch.

**Figure 1: China's Bond Defaults**



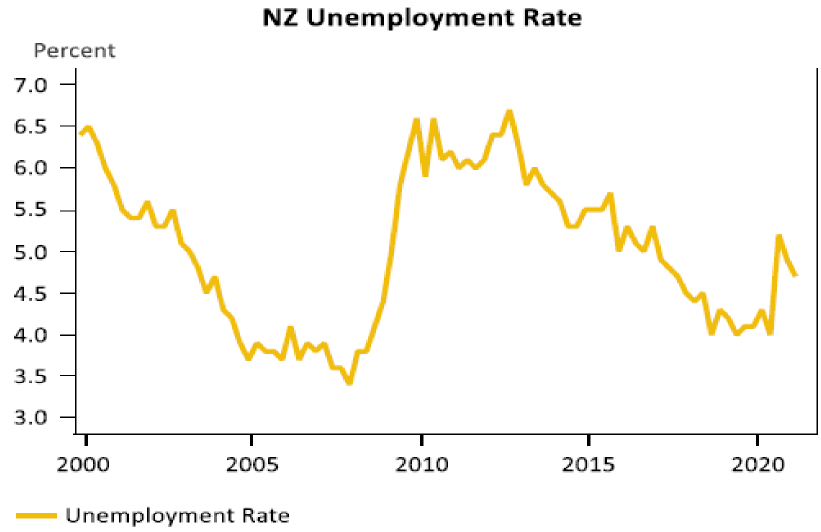

*Source: Bloomberg*

The Chinese relationship with Australia continues to sour. The overall trajectory of the dispute will continue to impact a range of commodities exported by Australia to China particularly wine, barley, beef, seafood and timber. Another trade war seems to be beginning and we hope it remains a cold tension.

## NEW ZEALAND OVERVIEW

Broadly, consumer confidence in New Zealand went up during April to 115 but is short on the historical average of 120. The unemployment rate dropped to 4.9% (see figure 2) due to increasing employed numbers in construction, rental and real-estate services, wholesale trade and (surprisingly) in education. Inflation was 1.4% for the year. The Current Account Deficit was $2.5b compared to $10.6b last year. National house prices have risen by 16.1% and the average NZ house price is $845,491. The regulator (FMA) continues to exert pressure on fund managers, KiwiSaver schemes and lenders – what has changed!

**Figure 2: New Zealand Unemployment Rate 2000 - 2021**

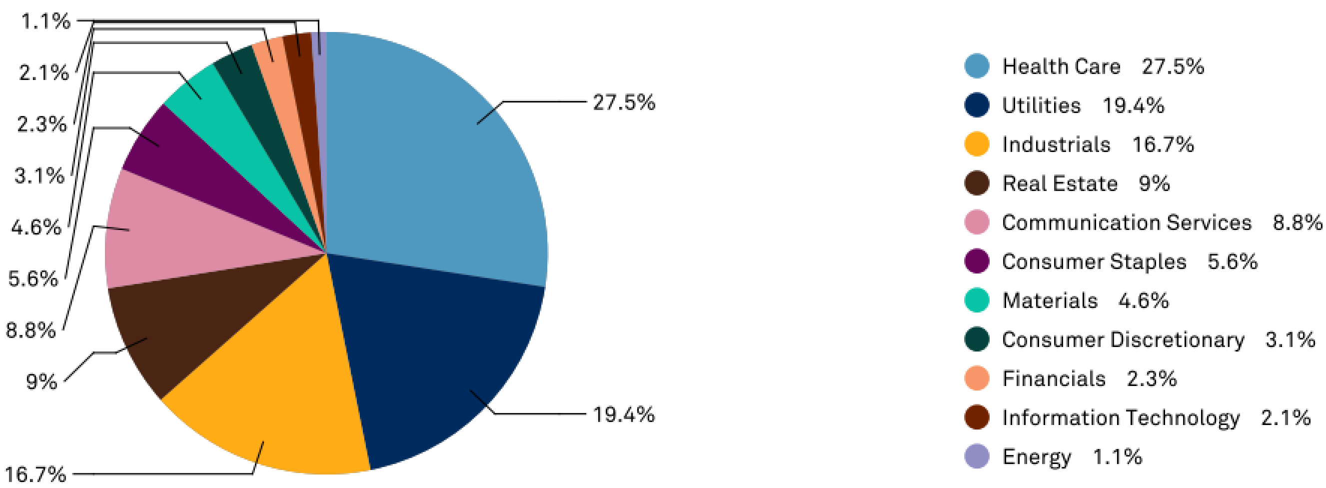



*Source: ASB*

The New Zealand equity markets were fairly neutral over April. However, structural issues in our local exchange persist, which include (but are not limited to):

- A shortage of listings on the NZX main board (only ~172). There are not enough incentives to list. We are seeing private equity deals go for 10-12x money and compared to the poorly performing recent listings of My Food Bag and Rua Bioscience, why would you go public?
- The market cap weighting is biased towards healthcare, utilities, industrials, real estate and communication services which collectively make up ~81.4% of the index. Where are the financials, technology, renewables, and future economy companies? The NZX main board is at risk of becoming stale when our best companies go overseas such as Xero and RocketLab.

**Figure 3: Sector Breakdown of the NZX**




*Source: S&P*

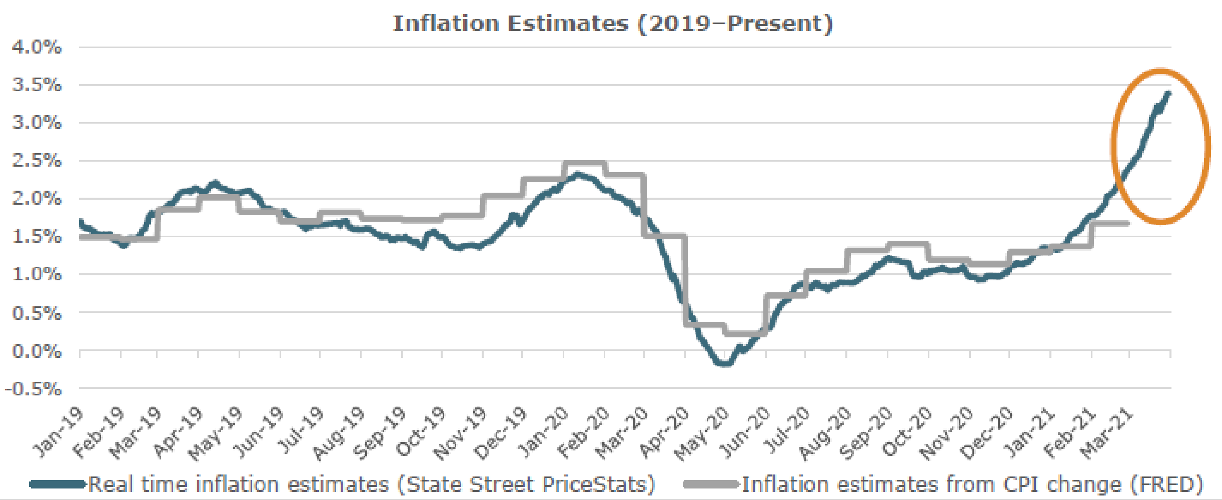
NZ start up success story, Sharesies, put the entire ASX on their platform during April. They now have the US, NZ and Australian main boards in their investment universe. The question is, will they list themselves? The private markets make up around ~85% of GDP compared to the 10-15% for public markets. To give the NZX the liquidity it needs to be a more successful exchange, we need to see the portion of GDP generated from public businesses increase which will only happen if there is sufficient incentive for the likes of Sharesies to list locally.

## FINANCIAL MARKETS

Markets are at an uncertain juncture where two scenarios have an equal chance of playing out. The first is the "lower-for-longer" perspective with low or negative returns and the second is a "roaring 20s" with high returns supported by higher economic growth.

Supportive factors for the first scenario are rising inflation, early tapering of quantitative easing (QE) by central banks, and geopolitical clashes. Real time inflation in the US based on millions of prices from online retail shown below in Figure 4 is estimated at 3.4% - which should be a big concern for investors. The Bank of Canada has announced its intention to taper down its asset purchases; being the first central bank to revise its economy's support measures.

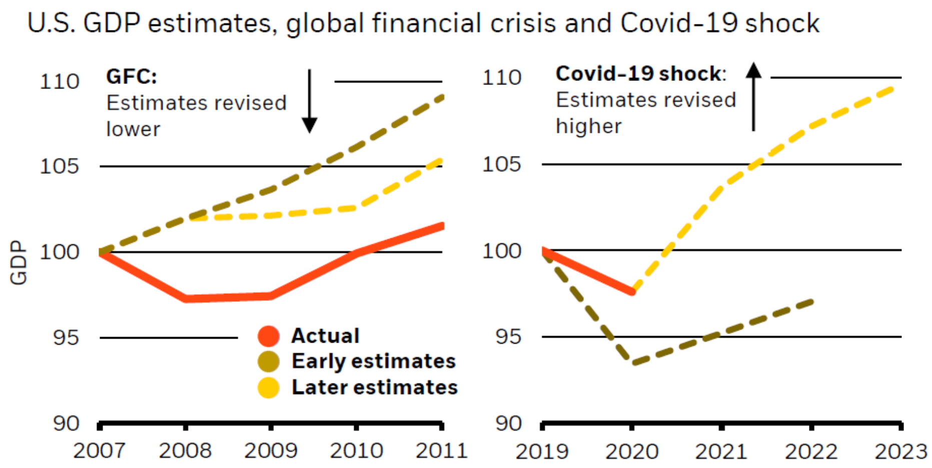
**Figure 4: Inflation Estimates**




*Source: AlphaSimplex*

The factors supporting the second scenario are a faster recovery based on the nature of the current crisis, fiscal stimulus, and vaccine roll outs created by a "COVID free bubble and corridor". The nature of the COVID crisis is more similar to natural disasters – drought, earthquakes, tsunami – that are followed by rapid recovery rather than a traditional cyclical crisis. Unemployment rates are close to pre-COVID levels, business activity is peaking up, and increased demand for flights in the US support this thesis. The Fed is likely to keep QE at its current level over the short term, trading economic growth for inflation. The vaccine roll out reached the critical 40% of the population which coincided with new virus cases declined. Figure 5 below shows US GDP estimates for the 2007-08 Global Financial Crisis (GFC) and COVID crisis at earlier and later stages.

**Figure 5: US GDP Estimates**




*Source: BlackRock*

## GOVERNMENT BONDS

Long term Government Bond yields moved around in April. The 10-Year New Zealand Government Bond (1.60% to 1.65%) was trading below its Australian counterpart (1.70% to 1.78%) during the second half of the month. We would expect to see the opposite, but these are far from ordinary times. It may indicate investors are viewing New Zealand as a safe haven relative to Australia after its ongoing verbal sparring with China. The US 10-Year Treasury (1.64%) has fallen from the beginning of April (1.73%).

A general decline in longer term rates is likely a balancing out of activity since the start of March where:

- The US 10-Year was only 1.4% which suggests it increased during March then pulled back in April; and
- The Australian 10-Year was 1.92%, and its New Zealand counterpart was 1.89%, suggesting a cooling in April of previous gains.

## CURRENCY

Throughout April, the declining US 10-Year Treasury Bonds somewhat explain the weakness in the USD. Rightly or wrongly, further improvement in risk appetite has manifested itself in a continued push in the equity markets, likely another headwind for the USD. The USD tends to weaken during periods when risk appetite is buoyant.

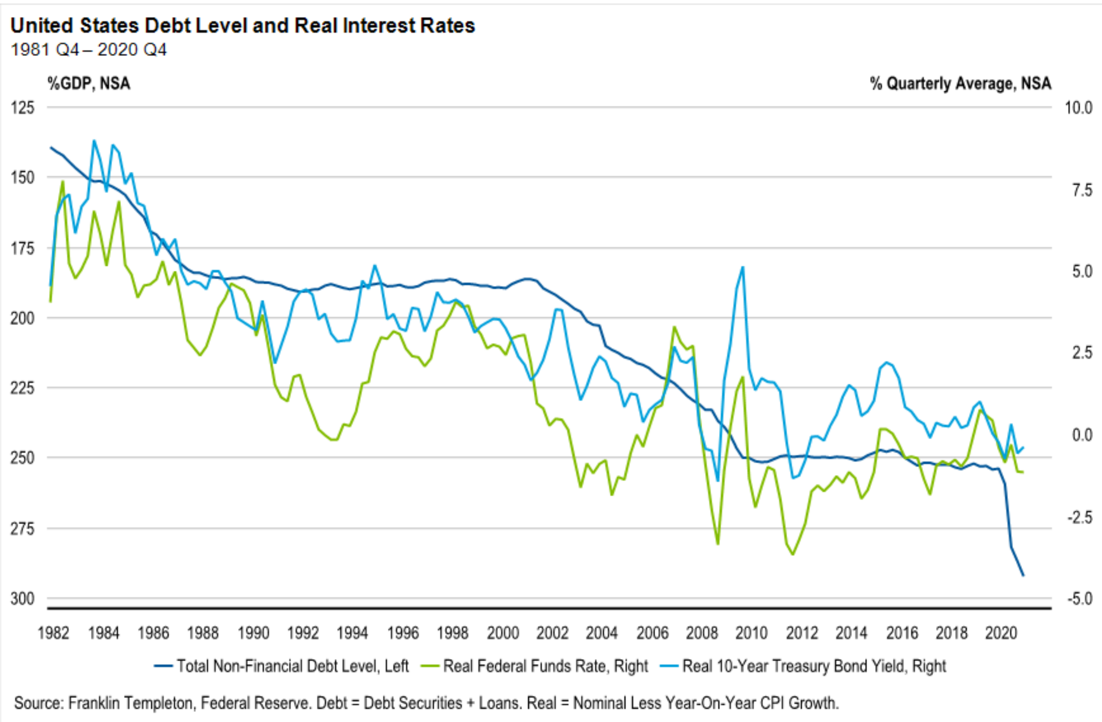
In late March, the NZD got smacked after the surprise housing policy announcement by the NZ government which coincided with a period of increased support for the USD. Since then, the NZD has been trying to regain lost ground. BNZ have mentioned a backdrop of higher risk appetites and commodities are a further headwind to the NZD pushing back to pre-tax announcement levels. In the meantime, a weaker NZD relative to USD bolsters unhedged global equity returns.

Central bank digital currencies are now well part of the agenda. China has a digital currency which is primarily used to monitor transactions, rather than democratise payments. Powell is not rushing a US version because he wants to make sure it is done right. Given crypto's popularity and the availability of technology to deliver it, we are interested in seeing how this develops. The only way in our view any currency can be a meaningful exchange of value and widely used in the economy by buyers and sellers is if the price is relatively stable. This is some way off for most cryptocurrencies, but maybe when all of Bitcoin is mined, we will see a stabilisation? Is the clock is ticking for Powell to put out a stable crypto currency before Bitcoin is fully mined and stable! We'll see.

## DEBT

Over more than 30 years, US non-financial debt to GDP has risen steadily. At the same time, the real (after inflation) Federal Funds Rate and 10 Year Treasury Yield has fallen. Successive crises have seen debt levels rise and the COVID crisis led to the most profound global borrowing peacetime exercise in history. The fact that borrowing growth has outpaced GDP growth over time highlights the marginal product of that borrowing is less than 1. In other words, borrowing has been inefficient: $1 of borrowing has led to less than $1 of real GDP. Is it any surprise that borrowing to bid up the price of other people's stuff (houses) doesn't really lead to growth?

**Figure 6: US Debt Level & Real Interest Rates**




*Source: Franklin Templeton*

Developed economies like the US, NZ and Australia remain stuck in a debt loop. Borrowing continues to outpace GDP, real rates remain compressed, wash, rinse, repeat and the band keeps playing! We will have more to say on this over the years ahead. When will the party stop?

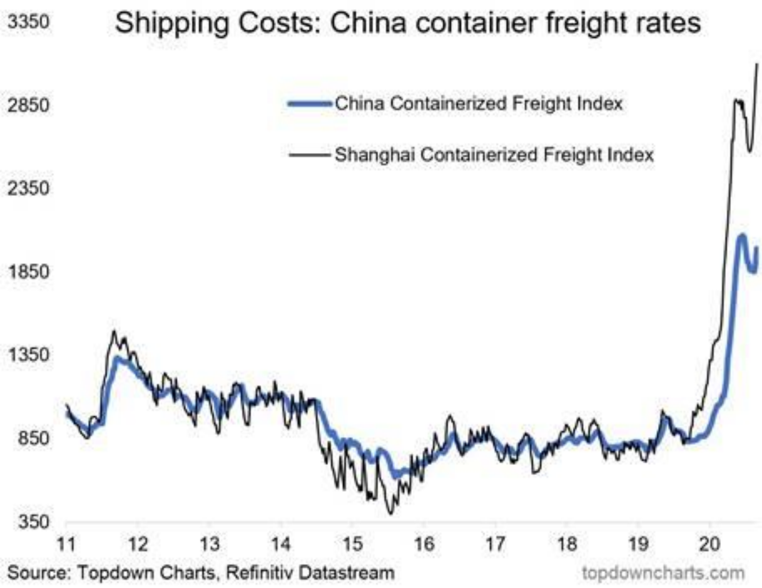
## INFLATION

Despite a mundane increase in NZ inflation of 0.8% in Q1 2021, BNZ have a strong view that, starting in Q2, annual inflation may jump to 2.5% from the current 1.5% because of a very weak quarter from Q1 2020 dropping out of the calculations. BNZ expects this to reach 2.9% by the end of 2021. Fasten your seatbelts!

We are seeing cost pressures rise generally, for example:

- Metals up 25% YTD;
- Baltic Dry Index at 18-month highs;
- House prices have increased ~25% over the last 12 months; and
- Wholesale electricity pricing index raised from 30.02 to 271.22 over the 12 months to 22 April 2021 which is a ~9-fold increase.

**Figure 7: Shipping Costs – Container Freight Rates**




*Source: Schroders*

How the Reserve Bank responds will be interesting as they have mentioned an appetite to “look through” inflation. This will test whether the inflation is transitory or more permanent. We do not understand how core inflation increases can be that transitory. It may be a bold move by Adrian Orr to ignore this for too long. The risk will be moving out of step with other central banks around the world which has the potential to create wide financial markets implications. Some fund managers have an expectation that inflation by the end of the year will start to see an upward trajectory.

Inflation expectations tend to have a modest impact on short term realized inflation. However, over the long term, rising expectations of inflation represent material risk. We recall that it took well over a decade for rising inflation expectations to transpire into above-trend inflation in the 1970s. We are relieved that Chairman Powell specifically addressed that time in history, in a recent speech reminding market participants that they are aware of the events that led to those historic inflation levels.

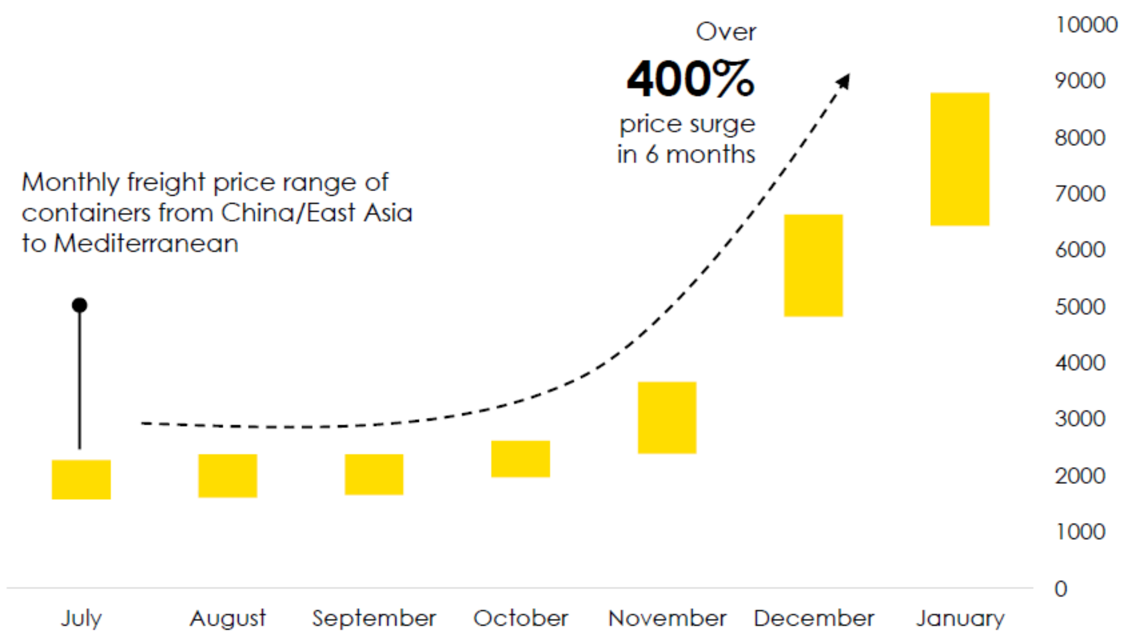
## SUPPLY CHAIN CHALLENGES

COVID-19 was a hard test for the world and proved the fragility of the modern supply chain. Throughout the last few decades, supply chains were focused on cost reduction and making streamlining with minimum participants, leaving them highly concentrated.

(Almost) all the eggs are left in one bucket - China. This has caused worldwide disruptions with limited supply of raw materials, spare parts, and ready to use products.

Consequentially, freight rates have increased significantly (+400%) (Figure 9). These costs will be passed on to consumers, pushing up inflation.

**Figure 8: Freight Prices**




*Source: Western Union Business Solutions*

A local example of supply chain disruption is the shortage of oxygen in India which caused the deaths of hundreds of people. India was hit by another wave of COVID that increased the demand for ventilation units and oxygen.

## GEOPOLITICAL TENSIONS

We are increasingly wary of the next shock to markets coming from another external event and the risk of a geopolitical incident is only rising. The key areas we are concerned about are:

- Africa - Chad, Somalia, Nigeria, Ethiopia, Congo
- China – Australia (US, NZ?)
- China – Taiwan (US)

- China – US
- (US) Israel – Iran (Russia, China)
- (China) Russia – Ukraine (US)

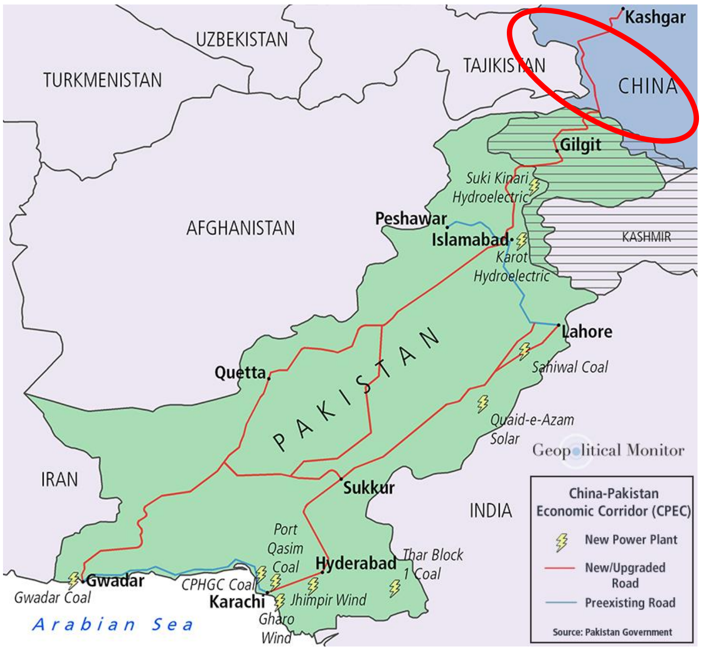
With minimal conflict during 2020, we are conscious of hot conflicts boiling over which have built up during the course of the COVID distraction.

China is still in the spotlight of geopolitical agendas with two main questions:

The first is the ageing population of one of the world's largest economies. China's population is ageing rapidly, due to its one child policy implemented from 1980 to 2016. An ageing population creates challenges not only for China, but the entire global economy. The possible consequences of an ageing population are pension deficits, debt crises, population shrinkage, and a slowing economy. A shrinking population can cause labour force shortages to sustain economic growth. Old and young age dependency ratios will reach 70 per cent by 2050 increasing the tax pressure on the current working population. Will it be possible for China to be a locomotive for the global economy in this situation? Is it time to start investing in India?

The second question is regarding ethnic cleansing in Xinjiang, an autonomous region in the north-west populated mostly by Uygur, Kazakh, Kyrgyz and other minority ethnic groups. Beijing has long considered this region as a rebellious centre, however, the conflict has escalated during the last five years. What exactly is behind this escalation - is it religion…ethnic questions…politics? If we look at the below map, (Figure 8) Xinjiang is the gate via Pakistan to the Arabian Sea – the shortest way to the Middle East oil resources and European export markets. Pakistan is an ally to China surrounded by Quad members (Japan in the west and India in the north) and plays on China-US and China-India tensions. The China-Pakistan Economic Corridor is one of the biggest foreign investments for China to eliminate the dependence on maritime routes for oil resources and bypass the straits of Malacca which is controlled by the US Fleet.

**Figure 9: Xinjiang Gateway**




*Source: www.geopoliticalmonitor.com*

Turkey is another hot point on the political scene. After the US turned its back on Turkey by recognizing the 1915 massacres of Armenians as a genocide, Canada banned the export of technologies used in Turkish drones. These drones were successfully used by Azerbaijani military forces against Armenian in the Nagarno-Karabakh region of Azerbaijan, occupied by Armenia from the early 1990s. Turkey is also supporting Ukraine, having recently issued a joint statement by the two presidents against Russia for annexation eastern territories and Crimea. This may have unpleasant consequences if Turkey remains involved in military action between Russia and Ukraine. Would the US and Canada support their NATO ally in this campaign?

New Zealand-China relations are under pressure as well. The "five eyes" members were not happy with close relations between New Zealand and China while the remaining members tightened up on the ethnic cleansing occurring in Xinjiang. Here is the dilemma: to either stand up against human right violations and support allies, or close our eyes and support our biggest trade partner. According to Stats NZ, China's share of NZ's exports was 32% and 23% of our imports. Politics or economy?

## GROWTH VS VALUE

Value performed their greatest quarterly result against growth stocks in 20 years during Q1 2021. Growth has seen a remarkable decade, but it is likely there are some headwinds to growth coming that may generally benefit value, including:

- Rising inflation;
- Rising real interest rates;
- Corporate profits growth rate; and
- Equity market volatility.

Interestingly, Vanguard have predicted that value will outperform growth over the decade by 5-7% per annum. As always, we are sceptical of predicting the future but appreciate their steadfast view. T. Rowe Price presented to us during the month and took a similar positive stance regarding value making a comeback.

## PRIVATE EQUITY MARKETS

Private equity markets carried on their strong momentum run from the last quarter of 2020. The number of buyout deals increased by 16%, reaching 1,675 and market value grew by 36%, reaching US$107 billion during Q1 2021. The main driver was the North American market. There are 4,661 funds seeking to raise US$907 billion worldwide.

## OTHER INTERESTING DISRUPTIONS: SPORT COMMERCIALISATION

Commercialisation of sport is accelerating.

Several football clubs in Europe set out to create a Super League to compete with UEFA. There were billions of dollars annually in advertising revenue at stake. The deal that has been a "threat" for 20 years received financial support from JP Morgan, the same bank that led the buyout of Manchester United 15 years ago.

The purpose of the deal was to divert control of football (or soccer…) away from UEFA and towards the clubs. While the deal impairs the chance of financial success among smaller clubs, ultimately it was likely about broadcasting capabilities and the revenue associated with that. If games can be shown live on a club owned site, then they can keep a larger portion of broadcasting revenue.

The whole thing was vetoed by the fans but nonetheless, the current standoff between the New Zealand Rugby Union and the New Zealand Rugby Players Association about whether to sell 12.5% of NZ Rugby for $387m to US Private Equity Juggernaut, Silver Lake, might find some learnings from the UEFA debacle. These deals in sport grab our attention because they highlight three important themes when running money and making vital commercial decisions:

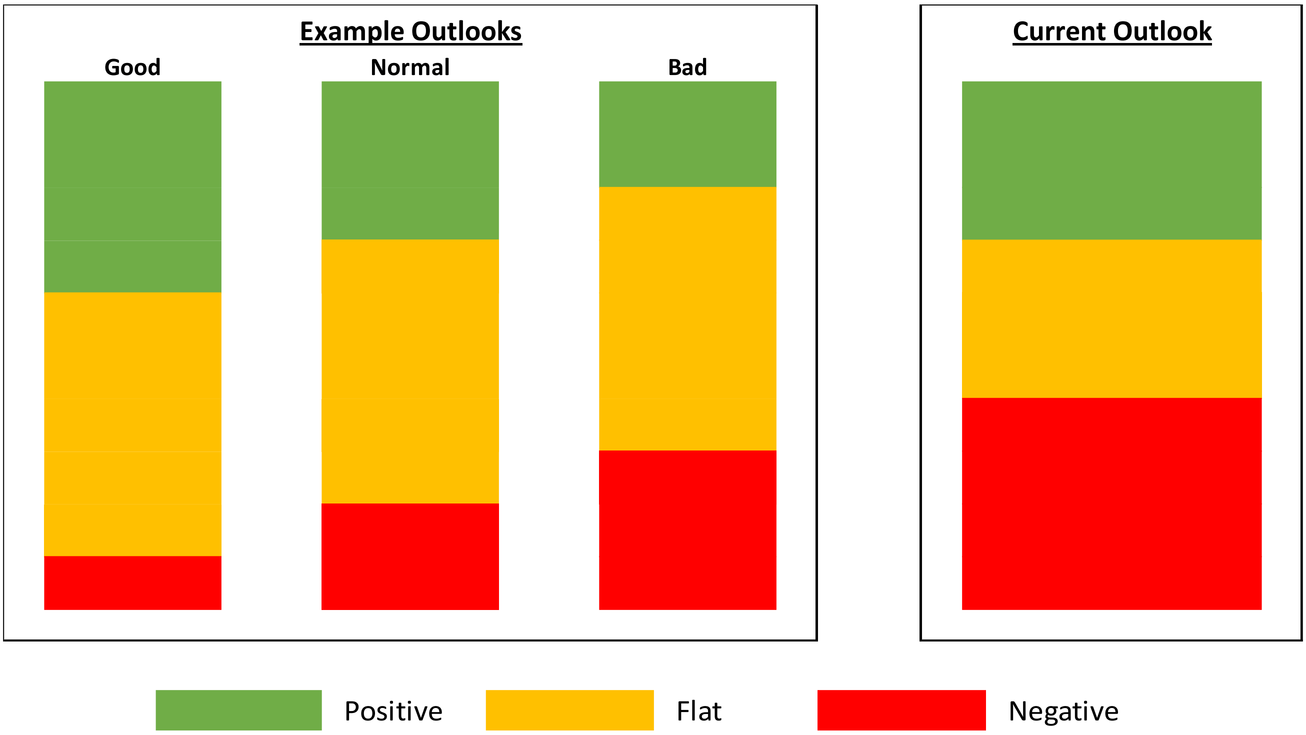
- COVID has stretched balance sheets and cash flows but making sure that new funding lines and their structure work for all stakeholders is key. There are many options, debt has never been cheaper, the government is happy to lend for rescue capital (Air NZ ~$900m) and growth capital (Team NZ ~$155m) for nationally significant issues, or float 12.5% on the ASX or NASDAQ? Kiwis can easily buy it through Sharesies if listed overseas. Main issue is that if the All Blacks need more money in 5-10 years, Silver Lake is likely to have right of first offer, taking another 12.5% chunk, etc.

- For such an investment, Silver Lake will need to tap new growth markets – the US and Japan, to make it worthwhile. It will also need a significant return on content without increasing the number of matches. Expect NFL type broadcasting with more in-depth player involvement off the field and behind the scenes footage. Amazon Prime has done this extensively. Again, textbook capitalism – wringing a barely half dry lemon when NZ Rugby is unable to do so itself.

- Old business models have never been under more pressure than now. Finding more streamlined ways of doing business and cutting the middleman has never been more necessary, and that is why we applaud the football clubs for attempting such innovative solutions. We appreciate NZ Rugby's predicament but would be interested to understand how they considered other funding options.

These questions are fundamental for all commercial organizations at various points in their life cycle. COVID just accelerated the need to answer these questions – what's new!

## MARKETS OUTLOOK




The current market is just as likely to have a good return (green) or average (amber) over the next two or three years or but somewhat more likely is a bad return (red).