ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – AUGUST 2021

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI Emerging Markets	771.58	2.3	-3.2	18.3
S&P 500 (US)	4522.68	2.9	7.6	29.2
Nikkei 225 (Japan)	28089.54	3.0	-2.7	21.4
FTSE 100 (UK)	7119.70	1.2	1.4	19.4
DAX (Germany)	15835.09	1.9	2.7	22.3
CAC 40 (France)	6680.18	1.0	3.6	35.0
Trans-Tasman Equities				
S&P/NZX 50	13218.83	5.0	7.3	10.7
S&P/ASX 300	85450.40	2.6	6.1	28.6
Bonds				
S&P/NZX NZ Govt Stock	1868.89	-1.3	0.0	-5.3
S&P/NZX A Grade Corporate	5827.25	-0.7	-0.3	-3.1
Barclays Global Agg (Hedged to NZD)	429.20	-0.2	1.6	0.7
FTSE WGBI (Hedged to NZD)	3703.85	-0.3	1.8	-0.1
Oil				
West Texas Intermediate Crude	68.50	-7.4	3.3	60.8
Brent Crude	71.24	-5.5	3.7	60.5
NZD Foreign Exchange				
AUD	0.9631	1.4	2.4	5.4
EUR	0.5963	1.3	0.1	5.5
GBP	0.5114	1.9	-0.1	1.3
JPY	77.3250	0.9	-2.9	7.9
CNY	4.5412	0.7	-2.1	-1.9
USD	0.7039	0.8	-3.3	4.1

Source: Nikko

Executive summary:

- US and global equity markets rose.
- Interest rates rose too.
- NZ dollar strengthened against the major currencies.
- Stock markets momentum appears choppy.

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ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

For the fifth quarter in a row, S&P 500 earnings results have been much better than expected with more than 85% having beaten earnings and sales estimates. Earnings are now nearly 30% higher than pre-pandemic levels, which helps to explain a tailwind to record high equity performance to date.

Federal Reserve Chair Jerome Powell in his Jackson Hole speech in the last week of August continued the process of gradually preparing the market for a tapering of quantitative easing, while indicating that rate increases are not imminent.

> "The timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest-rate lift off, for which we have articulated a different and substantially more stringent test," - Jerome Powell.

The Fed's gradual approach aligns with a view that policymakers are eager to avoid a repeat of the 2013 taper tantrum, when unexpected talk of tightening caused a sharp rise in yields and a fall in stocks. This time the S&P 500 went up 0.9%, while 10-year Treasury yields moved lower to around 1.33%, and the dollar fell.

Euro area CPI inflation data to 31 August were much higher than expected, with the annual rise in the headline figure jumping to 3.0% and the core rate up to 1.6%, the highest in a decade. Some special factors have driven inflation higher and near-term pressures remain to the upside, but expectations are that inflation will fall back down next year.

Canadian GDP unexpectedly contracted in Q2 and a preliminary estimate showed another decline in July, adding to the disappointment and hosing down expectations the Bank of Canada would taper its QE programme again next week. This decision is now likely to be deferred for another month.

August 2021 marked the end of a 20-year presence of US troops on Afghanistan soil. The Taliban needed just ten days to take control of the country. The next step in this terrible story is there may be more geo-political instability to come. The impact on the markets of this news was negligible. Interestingly, there was a turn to cryptocurrencies by the Afghani people because it is safer than the local currency at the moment.

LOCAL SNAPSHOT

New Zealand entered another national lockdown on 18 August caused by a Delta variant outbreak in Auckland. According to ASB the cost per day in lockdown is around $290 million.

The government has moved swiftly again to provide support to businesses and workers during Lockdown 2.0. Finance Minister Grant Robertson announced that both the Wage Subsidy and Resurgence Support payment will be made available. Important wage subsidy details include the following:

- The wage subsidy can be claimed if revenue falls, or is expected to fall, by 40% from current levels.

- Wage subsidy rates have increased, to $600 per full-time worker and $359 per part-time worker.

Back-of-the-envelope analysis shows that the wage subsidy could cover up to 1.25m workers, costing around $1.5b. This level of support would be slightly lower than the 1.68m workers supported to 12 June 2020 when the original wage subsidy ended, reflecting the higher qualifying threshold (a 40% decline in revenue rather than a 30% drop) and the economy's ability to adapt to Alert Level rises.

The S&P/NZX 50 rose 5% as the large-, mid- and small-cap segments all delivered hefty gains. Most S&P/ASX sectors gained, with consumer staples and health care both adding 7%, but none came close to the soaring tech sector, which finished with a colossal 17% total return, adding further complication to the difficult value-growth swings for portfolio managers.

WORLD FINANCIAL MARKETS

Equities

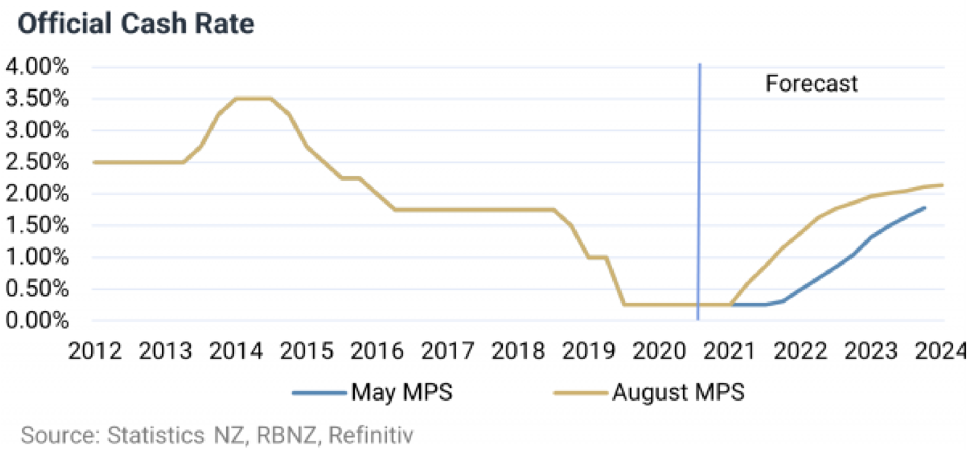
The S&P 500 passed a series of milestones in August: it reached its 50th all-time high for 2021, already more than in each of the past three full years; and it crossed 4,500 points for the first time, increasing its gain for the year to 20%. The achievement of this striking series of round numbers may seem surprising given the release of mixed US economic data throughout August, including weak retail sales figures for July, along with disconcerting COVID-19 developments.

Shares on the ASX have improved for an 11th consecutive month, the longest monthly streak in the market's history. The market gained 26.52 per cent over the past 11 months.

Fixed Interest

Considering the uncertainty emerging from the Government's announcement of a move to Level 4 restrictions, the RBNZ's Monetary Policy Committee (MPC) decided to keep policy settings unchanged at the release of the Monetary Policy Statement (MPS) on 18 August. However, the RBNZ economic forecasts, messages in the Governor's statement, and the record of the MPC deliberations were markedly more bullish than they had been previously.

FIGURE 1: NEW ZEALAND OCR



Source: Stats NZ

CLIMATE CHANGE

Severe climate events around the world this year have intensified debate around the effects of climate change and the risks they pose to portfolios. Investors should no longer view the transition to a low-carbon economy as a distant event, as it is happening here and now. Climate risk is investment risk, and the narrowing window for governments to reach net-zero goals means that investors need to start adapting their portfolios today.

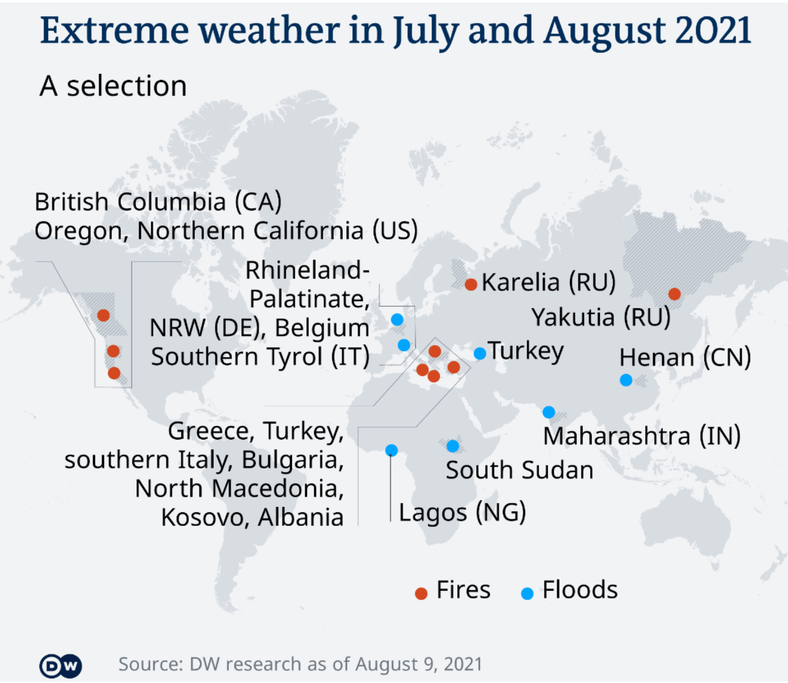
We are still in the early stages of a tectonic shift toward sustainable investing, and the full consequences of this shift are not fully reflected in market prices. The expectation that "green" assets are likely to benefit from the transition to a low-carbon economy will outperform during this shift is one reason for investors to keep tabs on the progress of climate change and that of climate transition. There are two key aspects in the climate transition: technology and policy. The tech transition has already begun in some key sectors such as utilities and autos. As the window to achieve net zero by mid-century narrows and policy levers are pulled harder, a steeper transition could ensue. Look no further than the recent NZ government's purchase incentives for electric vehicles.

Extreme weather events have helped elevate climate risk to a key concern among investors. Consider the two baskets of climate risks:

- Physical risks, such as hurricanes and wildfires and their potential damages to real assets; and
- Transition risks, such as financial risks arising from the transition to net-zero, stemming from changes in taxes, regulation, technology and business models.

July and August 2021 have been marked by extreme weather conditions — from drought and fires in Southern Europe, Russia and North America to severe flooding in Western Europe, Africa and Asia.

FIGURE 2: EXTREME WEATHER



Source: DW Research

Climate change is being seen in New Zealand, too. Winter 2021 was the warmest on record, while some parts of the Canterbury floods in June were so extreme it was only expected to happen once every 200 years.

GEOPOLITICS

The situation in Afghanistan held the spotlight in August, where the Taliban overtook the country in less than two weeks without any significant resistance from the governmental forces. The withdrawal of US and NATO forces have created a challenge not only for the population of the country but also for the neighbouring states.

Fractures from inside the Taliban ranks has lowered the chances of uniting citizens under their governance. As a union of tribes, it has radical wings that want to return the nation under strict Shariah laws, limiting the rights of women. Mujahideen in Northern Afghanistan is preparing for a war with Taliban and hoping on support from the West.

The exodus of the US has created a vacuum in the region that must be filled to avoid the escalation of destabilisation. The possible candidates are China, Russia and Turkey with the support of the EU:

- Russia is not rushing to replace the US, having its own sad history in Afghanistan. The USSR withdrew its troops at the end of the 1980’s which is when the Taliban first took control. The current situation (US withdrawal) is a case of history repeating.
- China prefers a pragmatic approach, taking the time to weigh the pros and cons of its involvement. They see Russia’s (the USSR) and America’s history and may consider a presence to be limited to constraining the conflict within the borders and preventing the spread in Central Asia and Pakistan, where they do have interests. It might be in a way of an exchange of money for peace (not supporting Muslims in Xinjiang) and using the Taliban as a clique against the US.
- Turkey wants to expand their area of influence following pan-Turkism ideology in Central Asia region under Erdogan’s ruling but have limited resources for that. Turkey is willing to increase their influence in the region and be an intermediary between the West and Taliban using the EU’s money to maintain peace in the region. Turkey did not withdraw their forces in August, keeping them posted at Kabul International Airport in non-combat mode to support the evacuation of troops and civilians.

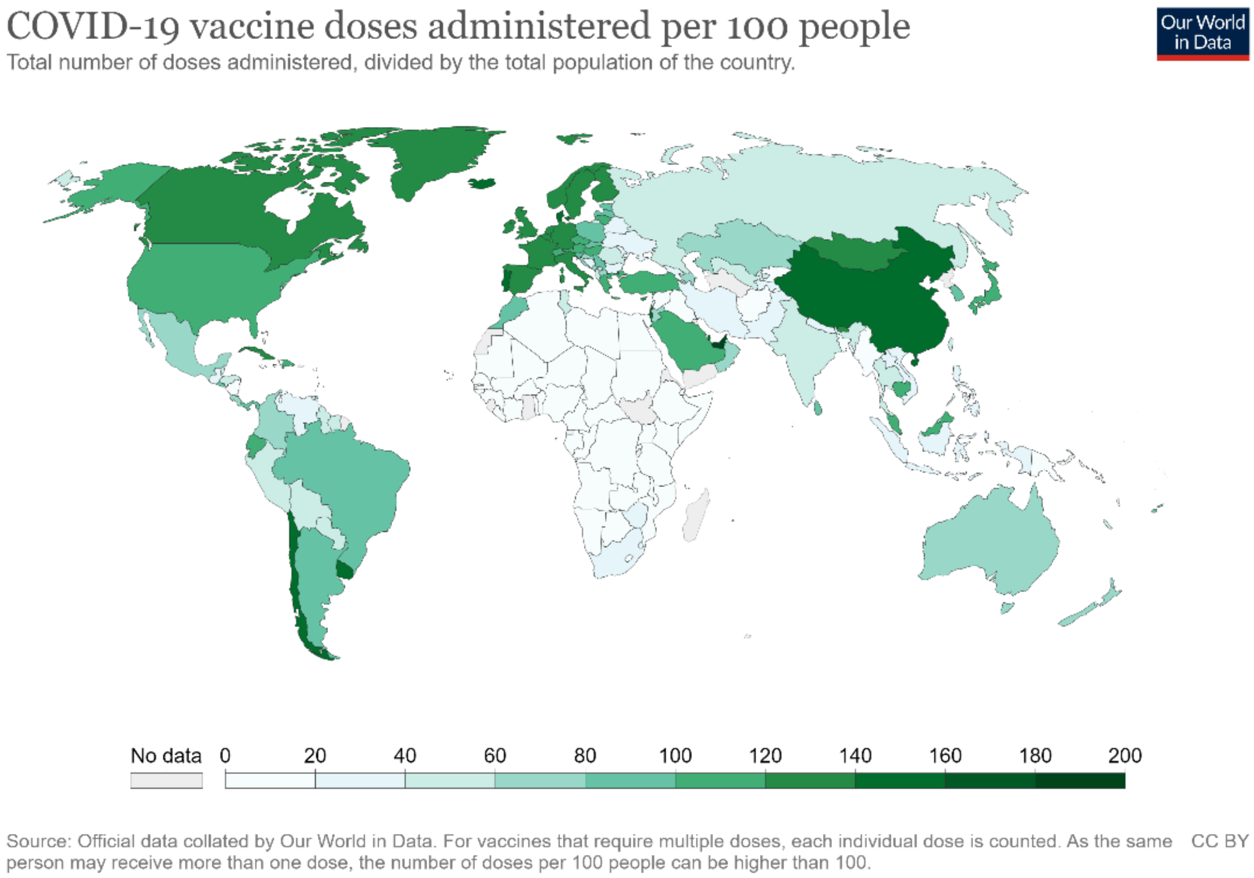
US-China tensions are still on the geopolitical agenda. A recent survey revealed that more than half of Americans questioned said they favour using US troops to defend Taiwan if China was to invade the island. Analysts say that reflects a growing awareness in the United States about Taiwan and the challenges it faces. Taiwan has found supporters not only in the USA but in Japan too. China’s growing assertiveness toward Taiwan has triggered a public push by Japanese leaders to plan for a possible conflict, a shift that could lead to closer cooperation with the US military.

COVID-19 PROGRESS

Globally, the pace of vaccinations accelerated to around 38 million daily towards the end of August. This was below the peak in June of 43 million but up from around 20 million in May, according to Our World in Data.

Meanwhile, studies continue to show that vaccinations are weakening the link between infections, hospitalizations and deaths. Countries earlier in their delta wave—including the Netherlands, Portugal, and Spain—are bending the curve.

FIGURE 3: VACCINE DOSES



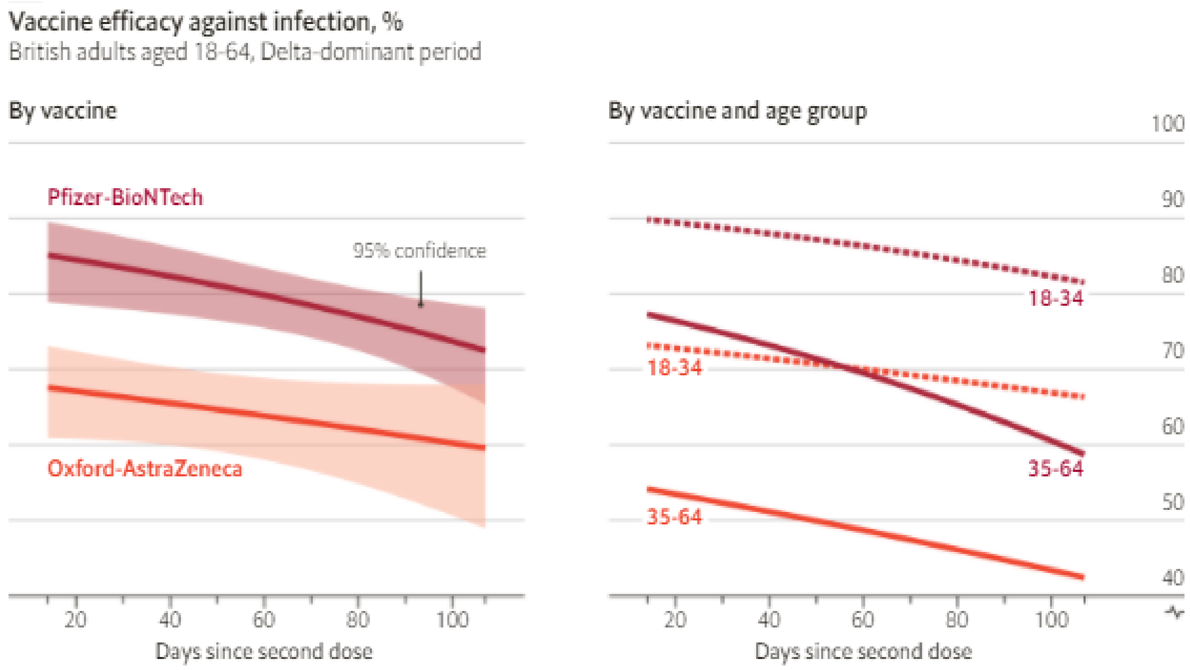
Source: Our World in Data

Notably, there was encouraging news towards the end of August that China had reported zero domestic COVID-19 cases for the first time since July. The authorities also reopened the Meishan terminal at the world's third-busiest container port following a two-week shutdown. These developments reinforce our view that the recent setbacks in China's efforts to combat the pandemic will be overcome without a significant disruption to international supply chains or a boost to global inflation.

A new preprint study by South Africa's National Institute for Communicable Diseases warns the new variant has "mutated substantially" and is more mutations away from the original virus detected in Wuhan than any other variant previously detected. The new variant, known as C. 1.2, first emerged in South Africa. It has a 1.7x to 1.8x faster mutation rate than the average of all other variants.

The speed of mutation has increased concerns about the efficacy of vaccination against new variants. The efficacy of vaccines against Delta variant decline by 20% over the hundred days from the second shot. It is obvious now that COVID vaccination would be seasonal like flu shots to keep the efficacy rate on higher level.

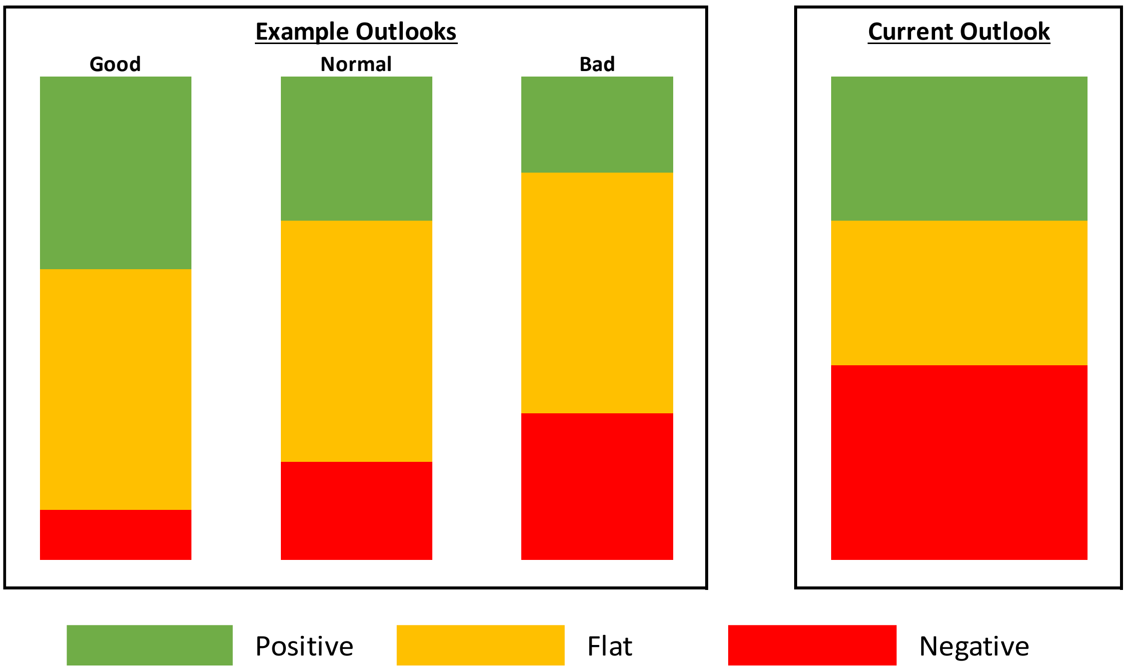
FIGURE 4: VACCINE EFFICACY



Source: Economist

Will pharmaceutical companies have the capacity to keep up the pace of COVID vaccine development with the speed of mutation?

MARKET OUTLOOK



The current market is less likely to have a good return (green) as an average return (amber) over the next two to three years. It is a little more likely to have a bad return (red).