ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – SEPTEMBER 2021

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI Emerging Markets	749.81	-2.8	-6.7	-3.1
S&P 500 (US)	4307.54	-4.8	0.2	8.4
Nikkei 225 (Japan)	29452.66	4.9	2.3	0.9
FTSE 100 (UK)	7086.42	-0.5	0.7	5.6
DAX (Germany)	15260.69	-3.6	-1.7	1.7
CAC 40 (France)	6520.01	-2.4	0.2	7.5
Trans-Tasman Equities				
S&P/NZX 50	13275.76	0.4	4.9	5.7
S&P/ASX 300	83837.98	-1.9	1.8	10.4
Bonds				
S&P/NZX NZ Govt Stock	1848.24	-1.1	-1.2	-1.0
S&P/NZX A Grade Corporate	5789.22	-0.7	-1.3	-1.0
Barclays Global Agg (Hedged to NZD)	425.08	-1.0	0.1	1.1
FTSE WGBI (Hedged to NZD)	3659.07	-1.2	0.0	0.8
Oil				
West Texas Intermediate Crude	75.03	9.5	2.1	26.8
Brent Crude	78.77	10.6	4.9	26.2
NZD Foreign Exchange				
AUD	0.9550	-0.8	2.6	3.6
EUR	0.5952	-0.2	1.0	5.6
GBP	0.5116	0.0	1.1	0.1
JPY	76.9700	-0.5	-0.8	10.3
CNY	4.4523	-2.0	-1.4	-0.7
USD	0.6899	-2.0	-1.3	4.4

Source: Nikko

Executive summary:

- Equity markets fell except New Zealand and Japan
- Interest rates rose as inflation pressures continued
- NZ dollar weakened
- Investors became more nervous

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ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

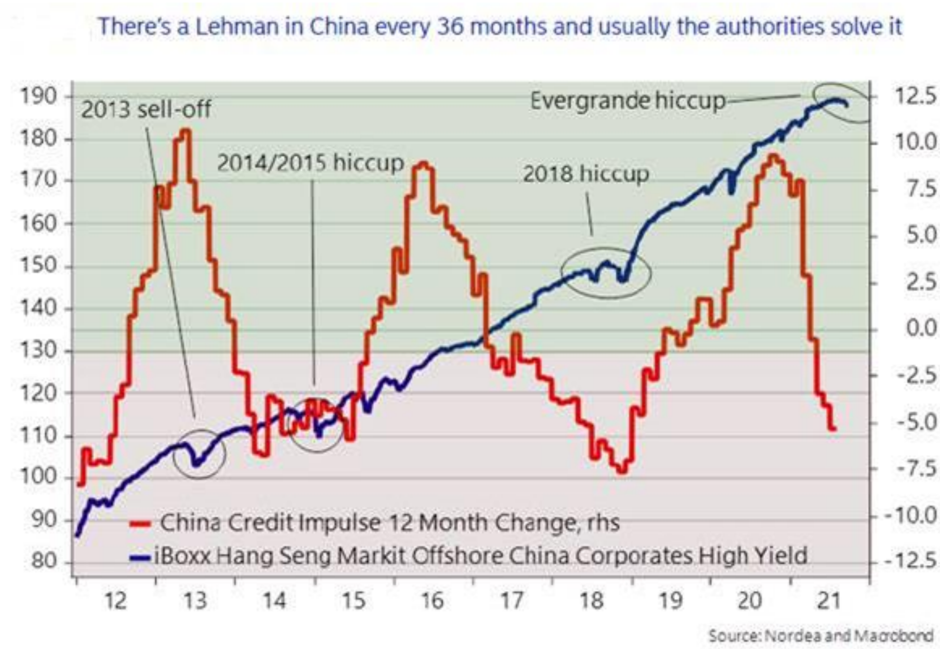
The attention of investors in September was caught by China's second largest property developer, Evergrande Group. Evergrande has become the most indebted developer in China with more than $300bn in liabilities. Dozens of sprawling residential projects stalled with an estimated 1.5 million unfinished apartments up in the air that it needs to deliver to investors.

The potential collapse has sent shockwaves through the finance and property sectors. It has prompted concern that it could affect China's entire financial system and broader international markets. However, further contagion doesn't seem to have taken hold at this stage.

We wonder how it will affect iron ore prices. On 23 September, the Fitch Ratings agency downgraded its forecast for China's economic growth, saying the "main factor weighing on the outlook is the slowdown in the property sector". Some analysts fear it could turn into China's 'Lehman Brothers moment', sending shockwaves through the world's second biggest economy.

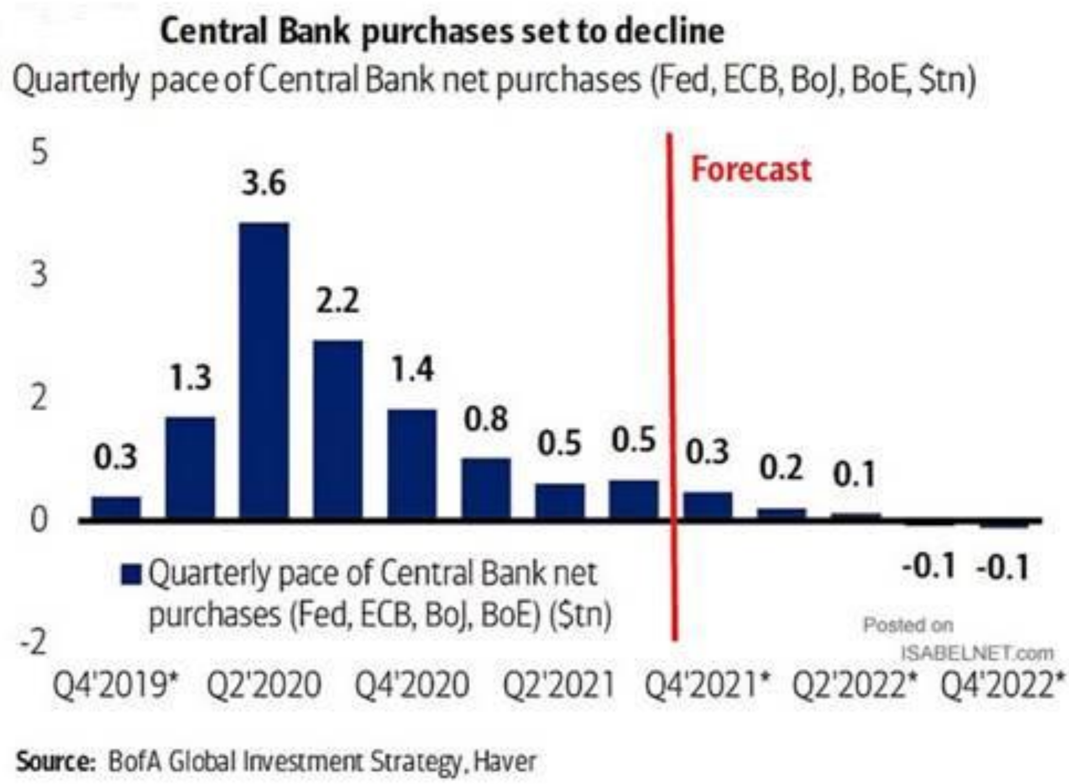
There is much speculation over whether the central government will step in. Under the leadership of Xi Jinping, the Chinese Communist party has been closely examining the country's private sectors. Everything from tech giants, individual moguls, private education, social media, ride-sharing apps, streaming platforms and the entertainment business have been dragged through regulatory overhauls. History has shown that an "Evergrande" equivalent has occurred every three years and has been settled by authorities (Figure 1). Evergrande has already missed the coupon payments on its USD denominated debt and has agreement to restructure CNY debt. Investors are nervous about what will happen next.

Figure 1



Another prominent theme is tapering. As widely expected, US policymakers announced they would soon consider tapering the central bank's purchases of Treasuries and mortgage-backed securities, a move that would reduce some downward pressure on longer-term interest rates. In his post-meeting conference, Fed Chair Jerome Powell reiterated that he would be looking for continued improvement in the labour market before acting, although he did not need to see a "knockout" payroll number for September.

Figure 2

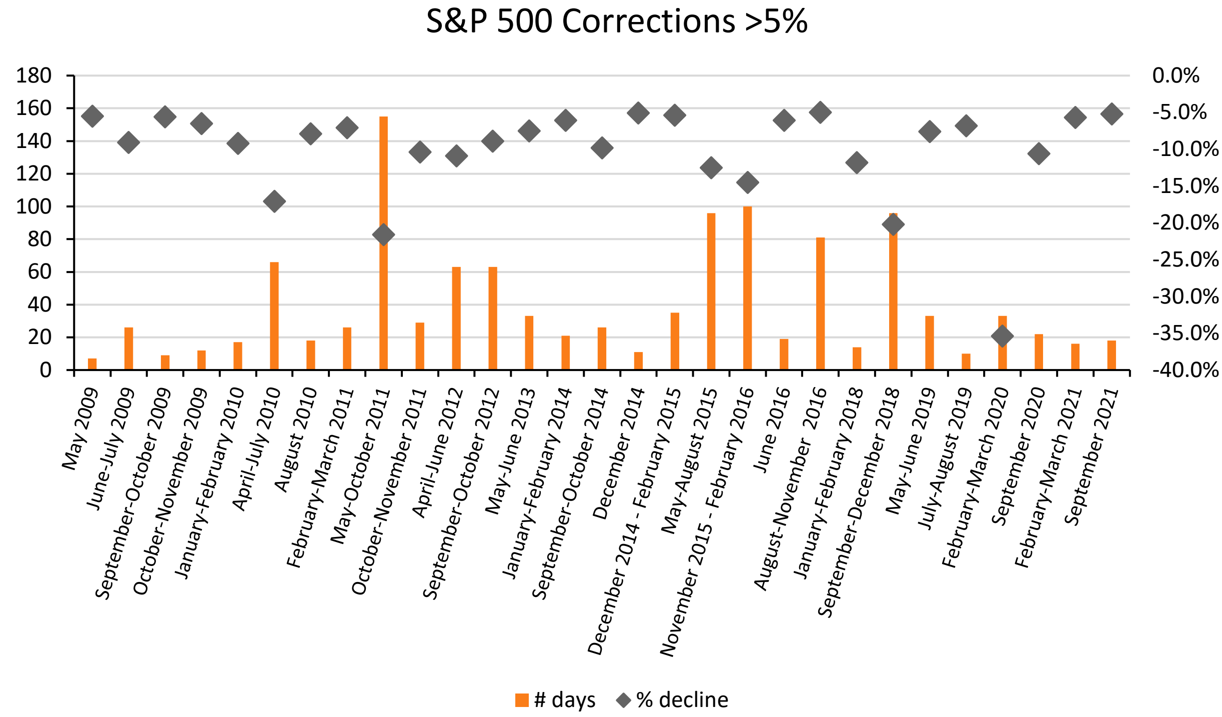


Norway became the first G10 country to tighten its monetary policy, with the central bank raising its key short-term lending rate to 0.25% from 0.00%. Norges Bank Governor Øystein Olsen said there would probably be another rate increase in December.

Bank of England's Governor Andrew Bailey repeated comments from the recent meeting minutes to clarify that unwinding stimulus should come from an increase in the Bank Rate that could occur even before the end of their asset purchase program (to cease at the end of 2021).

These themes set a risk off tone for markets in September. The S&P 500 fell 5.2% which was the second correction for the index in 2021 (Figure 3). Some experts expected to see a correction that could go as deep as 20% or 25% from the last all-time high. But it is still too soon to call.

Figure 3



Source: compoundadvisors.com, EriksensGlobal

LOCAL SNAPSHOT

As expected the OCR was lifted by the RBNZ from the 0.25% emergency setting it has been at since March 2020 up to 0.5% on 6 October 2021. The markets had previously been freely speculating that the RBNZ might be tempted to kick off what's expected to be a series of rate rises with a double move up to 0.75%.

However, in comments circulated at the end of September - and clearly aimed at dampening market speculation - RBNZ Assistant Governor Christian Hawkesby said: "When there is a typical amount of uncertainty, and the risks are evenly balanced, then central banks globally tend to follow a smoothed path and keep their policy rate unchanged or move in 25 basis point increments."

Stats NZ said the 2.8% rise in June 2021 quarter GDP was led by the services industries. The primary and goods-producing industries also contributed to growth. Retail trade and accommodation was the largest contributor, driven by higher activity in accommodation and food services. The latest lockdown is expected to add more volatility in GDP over the third quarter.

The Auckland region was still in Alert Level 3 with limited business activity. The continuing lockdown forced many business owners to close their doors. David Webb, national head of restructuring services at Deloitte says during the most recent lockdown, calls from business owners seeking help more than doubled, reaching the highest levels the advisory firm experienced since the start of the pandemic.

Another cyber-attack happened in September that took down the websites and mobile apps of several companies. Among the victims were NZ Post and some banks. New Zealand already had Denial-of-Service (DoS) attacks on the NZX and other companies earlier this year.

WORLD FINANCIAL MARKETS

Equities

US and European equities fell sharply as bond yields rose further. Concerns included the energy price squeeze and the US debt ceiling. US data on consumer confidence and manufacturing sentiment also weakened notably.

The S&P 500 and the Nasdaq headed for their worst day in four months on 28 September as weak consumer confidence data deepened concerns over slowing economic growth, while a surge in Treasury yields hit mega-cap technology stocks.

There was a significant loss over six days for shares on the ASX. The All Ordinaries closed down 110 points, or 1.43 per cent, to 7580. The losses followed US bond yields rising overnight, which generally makes shares less attractive to investors.

Fixed Interest

US bond yields continue to rise despite sell off in equities as hawkish comments from the Fed remains the central focus for markets.

- 2 year government bond yields traded at 0.30%; and
- 10 year government bond yields rose from 1.50% to 1.57%, the highest level in 3 months, before settling at 1.54%.

Australian bond yields have followed price action from its US counterparts as domestic price movers should remain on hold until early next month when lockdown restrictions are eased.

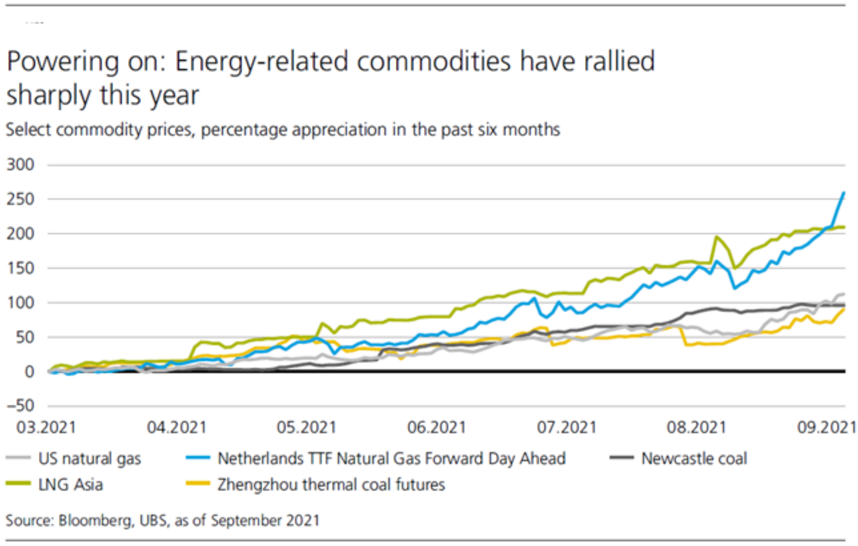
- 3-year government bond yields (futures) traded at 0.47%; and
- 10-year government bond yields rose from 1.48% to 1.53% before settling at 1.50%.

ENERGY CRISIS

Prices for key commodities used in power generation have risen substantially in 2021. Over the past month, US natural gas prices have hit a seven-year high; LNG and coal prices have now more than doubled since the start of the year; and yellowcake uranium is up by around a third so far this year, reaching its highest level since 2014.

A number of specific factors have pushed prices higher this year, but the rise is also indicative of the desire to reach net-zero carbon and the need to invest in more renewable capacity.

Figure 4



Source: Schroders

This year's move started in thermal coal, for several reasons. On the supply side, these include China's ban on Australian imports of the commodity, Indonesia's restrictions on coal exports (which are now being relaxed), Chinese mine closures for safety and environmental reasons (now also being relaxed), and problems with exports of Russian and South African coal. Higher coal prices have had a knock-on impact into higher gas prices, driven by power generators with the capacity to switch fuels.

But the price rises are also linked to the shift toward net-zero carbon. Supply constraints in coal come on top of a well-established trend for lower investment in coal production as companies focus on shareholder returns and investors question the longevity of the industry as we transition to renewables. In the uranium market, electricity generators are competing for raw materials, with investment funds backing the view that nuclear energy will be an important part of the trend toward net-zero carbon. Demand for gas, which at the margin has been driven by this year's tightness in coal, is underpinned by its role as a lower-emissions fuel than coal. The interrelationship between commodities and net-zero carbon also reaches beyond fossil fuels into industrial metals, such as copper and nickel, which are essential inputs for renewable energy technology and infrastructure.

Investment in fossil fuels is being run down but is yet to be replaced by sufficient renewable capacity. Hence, we believe this year's supply-side constraints and outsize impact on commodity prices could become more common over the next few years. For example, warm weather in the UK in September reduced wind power generation and required mothballed coal power generators to be restarted to meet electricity demands.

The global energy transition is set to continue, as are these tensions between fossil fuels and the availability of reliable renewable power. Governments, businesses, and consumers are simultaneously looking to reduce emissions while increasing capacity to produce and store renewable power, but this will not happen overnight.

The UK experienced a petrol shortage in September, pushed by an absence of truck drivers to deliver the fuel. At the same time there were reports of blackouts in China due to a shortage of coal supply and strict pollution controls. Coal inventories in India are also nearing their lowest levels since 2017, as prices of the black fuel are nearing $200/tonne, up from a meagre $50 during the pandemic. Couple that with surging freight costs, due in part to the chess game of relocating containers, but also the retirement of many ships due to stricter environmental standards, and there is a perfect storm brewing in energy and transport. Overall, the story is inflationary, and while central banks continue to rehash the transitory mantra the signs are getting more concerning. If there is another black swan hiding amongst the COVID pandemic recovery narrative for 2022, it could play out in further price hikes and energy insecurity.

HI-TECH

Ford invested $50 million into battery-component company Redwood Materials, a company founded by the former Tesla battery chief J.B. Straubel. Redwood Materials plans operations in battery recycling and manufacturing copper foils, a critical battery component. The partnership with Redwood Materials allows Ford to secure its future battery supplies.

Redwood Materials plans to build one of the largest battery materials factories in the world. The new $1 billion US factory will produce enough materials by the end of 2025 to be on par with the biggest producers in Asia. By 2030, production capacity should have increased 5x, with $25 billion worth of materials produced each year. With widescale vehicle electrification on faster timelines, Straubel states there is enough market demand for another four companies like his.

FedEx and self-driving vehicle startup Aurora Innovation have launched a pilot program for autonomous truck shipments. The initial fleet will have a modest number of autonomous trucks and use backup drivers for safety. Aurora aims for trucks without a safety driver by late 2023. In July, Aurora announced its plans to merge with a SPAC (Special Purpose Acquisition Company) backed by Silicon Valley heavyweights Reid Hoffman and Mark Pincus. The goal is to raise about $2 billion at a valuation of $13 billion. The company believes it will be the first to commercialize self-driving technology at scale for the US trucking market.

The UK has released a new ten year “National Artificial Intelligence Strategy” to become an AI superpower and boost investments in British AI startups and the use of AI in British businesses.

GEOPOLITICS OR GEOECONOMICS?

The Taliban formed a government in Afghanistan and is the only power controlling the majority of the country – and they will need money. Afghanistan could offer mineral resources that, according to the United States Geological Survey (USGS), are worth USD $1 trillion. Among these the most highly valued is lithium, for use in tech industries. Other income streams include opiates distributed illegally to Europe. This socio-economic picture is going to change drastically with increased poverty, poorer social environments, and less employment opportunities.

It’s likely that the Taliban consider China as a partner and the situations in Xinjiang likely do not bother them. What matters now is money, not politics or religion.

US-China relations saw less confronting rhetoric and some sign of "warming". Huawei's CFO Meng Wanzhou left Canada and returned to China after reaching an agreement with the US government on charges of fraud. Meng was arrested in December 2018 by Canadian authorities on instruction from the US. On the same day, two Canadians were released by China after more than two-and-a-half years of arbitrary detention. Is this a change in foreign policies or just one-off gesture of kindness? The energy crisis might be the cause of this warming allowing the superpowers to concentrate on the common problem of energy security before winter comes.

COVID-19 PROGRESS

Vaccines offer a route to treating COVID-19 as an endemic disease. By weakening the link between new cases, hospitalizations, and deaths, vaccines are the key for economies to manage COVID-19 as an endemic disease rather than as a pandemic requiring lockdowns. A recent report by McKinsey highlights that the rate of hospitalizations in the US for COVID-19 among the vaccinated (21 per million in the week to 29 August) was about the same as for influenza historically (26 per million on average between 2010 and 2019).

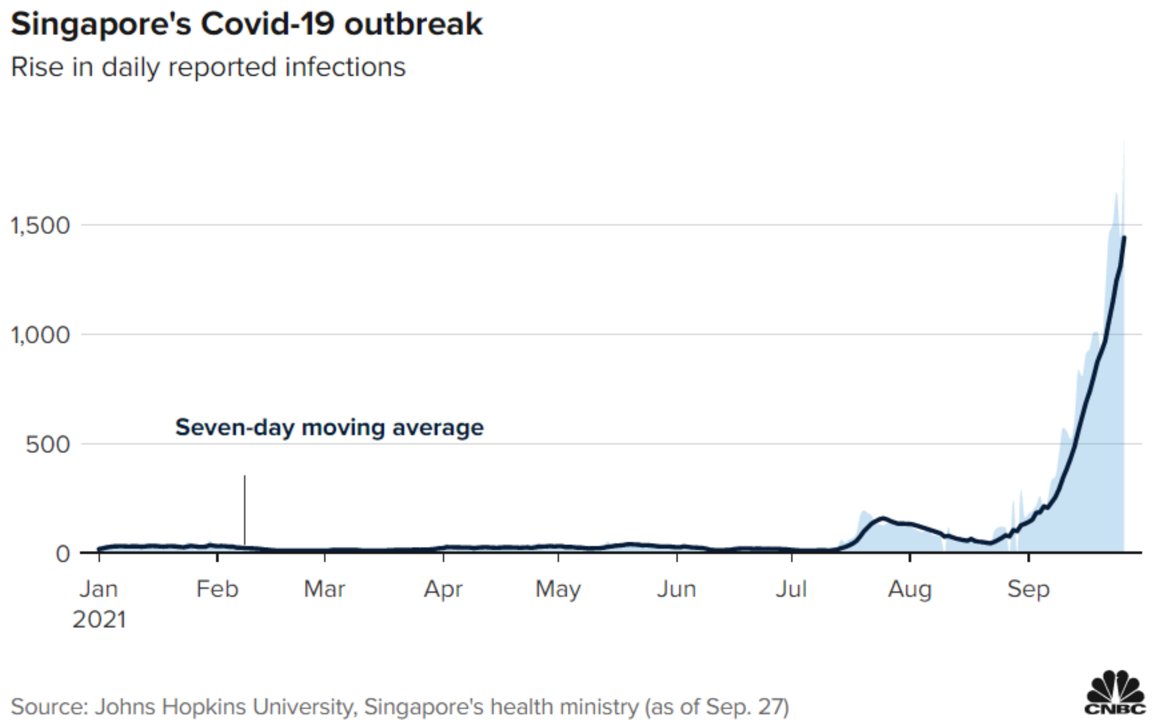
Since the onset of the pandemic, the UK has imposed two national lockdowns with staggered reopening. More recently, the government has chosen to continue to relax restrictions despite rising case numbers of the delta variant, relying instead on the effectiveness of vaccines to reduce the level of hospitalizations and deaths.

According to Public Health England data, two doses of the Pfizer-BioNTech or Oxford-AstraZeneca vaccine are estimated to be 96% and 92% effective respectively against hospitalization with the delta variant. This is broadly in line with data from the US Centers for Disease Control and Prevention released this month, showing 90% effectiveness for vaccines against delta, and a study by Germany's Robert Koch Institute showing that unvaccinated people were 10 times more likely to be hospitalized.

In the UK, 81% of the population over 16 years of age (those more vulnerable to being hospitalized) have been fully vaccinated. Consider 1,000 people who were hospitalized prior to the availability of vaccines. Today in the UK, 81% have been fully vaccinated, with an average 94% protected against hospitalization. Compared with 1,000 hospitalizations prior to vaccines, only 190 unvaccinated people would now be hospitalized (assuming the hospitalization rate among the unvaccinated is unchanged). Of the remaining 810 vaccinated people, only 49, or 6%, would end up in hospital, to give a total of 239—a 76% reduction in hospitalizations. In other words, for any given number of hospitalizations, case numbers need to be 4.2x higher than prior to the availability of vaccines.

Singapore's health-care system and workers have been strained by the increase in cases, and there is a need to slow down transmission to avoid seeing more infections in vulnerable groups such as the elderly, according to the health ministry.

Figure 5



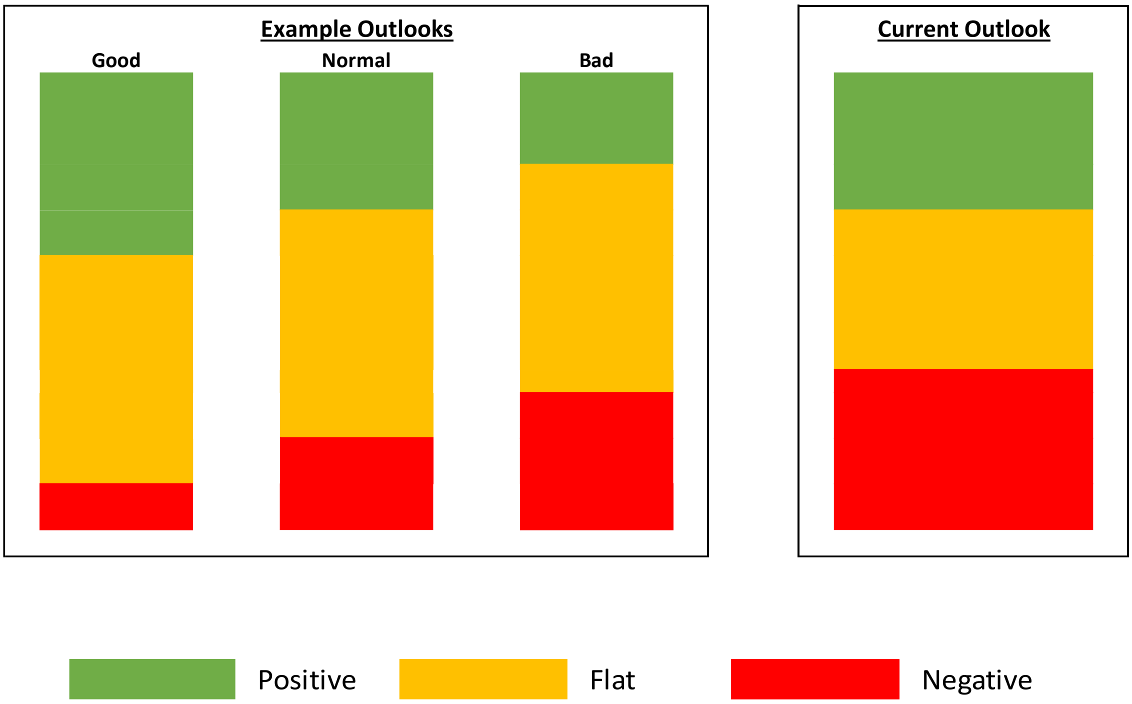
Source: John Hopkins University, CNBC

Around 82% of Singapore's population has received two doses of a Covid vaccine. Health authorities said 98% of infected individuals had no or mild symptoms over the last 28 days. Case numbers may remain high for a few months, but the "vast majority" will be well protected by the vaccines and won't fall seriously ill, according to the Saw Swee Hock School of Public Health at the National University of Singapore.

The long-term plan against Covid is a combination of vaccination and natural infection to provide protection while not overwhelming hospitals, adding that it is not anticipated the death rate will increase but the absolute numbers can be expected to rise.

There are few reasons for higher hospitalization rate in Singapore. First, hospital beds are filling up because of the country's "very cautious" approach, and not because that many people need acute medical care. Second, Singapore has a higher population density and mild climate that increases the transmission rate.

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). The risk of a correction is reduced marginally compared to the last one we had.