ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – NOVEMBER 2021

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI Emerging Markets	732.13	-3.2	-5.1	4.3
S&P 500 (US)	4,567.00	-0.8	1.0	26.1
Nikkei 225 (Japan)	27,821.76	-3.7	-1.0	5.3
FTSE 100 (UK)	7,059.45	-2.5	-0.8	12.7
DAX (Germany)	15,100.13	-3.8	-4.6	13.6
CAC 40 (France)	6,721.16	-1.6	0.6	21.8
Trans-Tasman Equities				
S&P/NZX 50	12,718.91	-2.9	-3.8	-0.4
S&P/ASX 300	83,475.36	-0.5	-2.3	16.0
Bonds				
S&P/NZX NZ Govt Stock	1,804.30	1.0	-3.5	-7.5
S&P/NZX A Grade Corporate	5,680.26	0.5	-2.5	-5.1
Barclays Global Agg (Hedged to NZD)	427.44	0.8	-0.4	-0.6
FTSE WGBI (Hedged to NZD)	3,700.44	1.3	-0.1	-1.1
Oil				
West Texas Intermediate Crude	66.18	-20.8	-3.4	46.0
Brent Crude	69.75	-16.9	-2.1	47.9
NZD Foreign Exchange				
AUD	0.9572	0.5	-0.6	0.4
EUR	0.6030	-2.5	1.1	2.6
GBP	0.5130	-1.7	0.3	-2.5
JPY	77.0630	-5.6	-0.3	5.2
CNY	4.3280	-5.5	-4.7	-6.4
USD	0.6787	-5.2	-3.6	-3.4

Source: Nikko

Executive summary:

- Equity markets fell due to Omicron fears in the last week
- Bond markets are up as yield curves flattened
- Short-term interest rates rose as inflation pressures continued
- NZ dollar depreciated against major currencies except AUD

Auckland
2 Burns Ave, Takapuna
PO Box 33-1318 Takapuna 0740
p: +64 9 486 3144
auckland@eriksensglobal.com

Wellington
Level 9, 111 The Terrace
PO Box 10-105 Wellington 6143
p: +64 4 470 6144
wellington@eriksensglobal.com

ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

November was eventful, but we kept our attention on rising inflation, signals of early tapering in the US, the spread of new variant Omicron and ongoing political risks in Europe.

US labour and consumption data were strong. Weekly jobless claims fell to the lowest level since 1969, with 199,000 claims reported. But core personal consumption expenditure (PCE) inflation reached 4.1% in the 12 months to October, which is its highest figure since 1991 (Figure 1).

Figure 1

President Biden nominated Jerome Powell for a second term as Chair of the Federal Reserve, and Lael Brainard for vice chair for monetary policy. Brainard is the only Democrat on the Board of Governors, is in favour of a Central Bank-backed cryptocurrency, and traditionally is the only opposer on the Board to financial regulation rollbacks. Federal Open Market Committee (FOMC) minutes also showed support for a swifter tapering of bond purchases. This hawkish news impacted markets and on 26 November markets pivoted amid concerns about changes at the Fed and renewed fears about the pandemic.

While several studies on vaccine efficacy and Omicron are in progress, the results are still about a week away as at 10 November 2021. What the drug companies do know is that third 'booster' vaccines do increase protection against Omicron – but that's not surprising. Markets are jumpy after the past two years, and the Omicron variant's potential impact on global GDP growth started a sell-off in risk assets on the last Friday of the month. The S&P 500 fell 2.3%, in the largest one-day decline since October 2020. The 10-year Treasury yield also fell 16 basis points, while the Cboe Volatility Index (VIX) jumped from 19 on 24 November 2021 to 31 on 1 December 2021.

Meanwhile, after the most remarkable and chaotic day on 24 November in modern Swedish political history, Magdalena Andersson resigned after seven hours as (the first female) Swedish Prime Minister – and was reelected the following Monday! Andersson, who has been Finance Minister of the Social Democrats since 2014, replaced Stefan Lofven as leader of the party after he retired from the role. The Social Democrats were in power due to a coalition with the Green party, but there are eight political parties in government, and it is increasingly fragmented. Once Andersson was accepted as Prime Minister, the Social Democrat's first critical budget vote was stymied by the Central Party's alternative proposal, leading the Green party to quit their coalition to avoid negotiating a budget with "Nationalists." Andersson, who is known for being an excellent negotiator, stated she didn't "want to lead a government whose legitimacy will be questioned." But as the frontrunning party, with just 28.3% of votes in the last general election, Andersson was promptly reinstated at the next parliamentary vote. "The big issue is the parliamentary situation, the weakness we have seen over the past 10 years. As far as most can tell that will be the same after the next election. It makes it difficult to raise … big important policy measures," stated Andreas Wallstrom, head of forecasting at Swedbank. And Sweden needs its parliament to be more unified, as its country is struggling with soaring levels of gun violence, racism and child poverty, which is blamed on their historically welcoming immigration policies, now largely revised. Germany, Austria and the Czech Republic have similar problems politically. The situation in Austria and the Czech Republic worsened on corruption allegations of countries' leaders. With Britain gone, the European Union needs its remaining states progressive and productive – not divided amongst themselves.

Figure 2

Confidence boost: from left, Andersson as the first female Prime Minister of socially progressive Sweden, seven hours before resigning, then again the following week after being voted back as Prime Minister. Source: BBC

LOCAL SNAPSHOT

The New Zealand government announced the country will move to a traffic light system on 3 December. It will allow all businesses to operate but with limitations based on vaccine pass monitoring policies.

ANZ Business Outlook Survey results for November saw business confidence fall, while cost and inflation pressures remained 'extreme'.

The biggest change in KiwiSaver since its inception occurred on 1 December, affecting the savings of more than 234,000 people invested in default funds. Those who haven't already actioned their own moves or confirmed their preferences, will transfer from Conservative to Balanced funds, as the Government attempts to increase the retirement savings of the public. We see this as an increased risk to the public, given the markets and the increased exposure to equities of Balanced funds as opposed to conservative funds. However the relatively stable cash inflows from KiwiSaver deductions to the share markets will act as a marginal rising tide for the NZX and ASX.

Supply and demand dynamics in the housing market are finally changing. Lofty house prices are at risk from the confluence of three big macro forces next year, being increased mortgage interest rates, tighter lending criteria and increased housing supply. ASB have updated their forecasts to take account of these risks, and now expect small falls in house prices over the second half of 2022. We believe that existing owners will hold on to what they have, but we look forward to new properties coming to the market that are well built and designed for the new generation.

Overall it's an uncertain time for the New Zealand economy: COVID is at risk of spreading throughout new regions; the housing market has turned; and interest rates have risen for another quarter. And now the global COVID situation has taken a turn as well with the uncertain implications of the new Omicron variant – and New Zealand's already used a lot of its powder in terms of government spending on vaccines, subsidies, and public sentiment seems to have turned against lockdowns. For now, demand is solid and jobs are plentiful, Aucklanders are free to roam (terrorise, or tourist) the country, and there's a plan to reopen the border, Omicron pending. The Delta outbreak hasn't exploded (yet?), hospital systems have coped, and New Zealand has achieved impressive rates of vaccination with hopefully more to come. The concern about government debt has also be waved away to some extent politically – if other Central Banks keep their rates low the interest can remain lower than inflation and GDP growth. We remain cautious even though 'everything is looking up.'

WORLD FINANCIAL MARKETS

Equities

Stocks dropped on the last day of November after Federal Reserve Chair Jerome Powell suggested an earlier end to bond tapering, with traders increasing their bets on the pace of interest-rate hikes. The S&P 500 slumped almost 2%, erasing its November gains. The VIX notched its biggest monthly surge since February 2020.

The Dow Jones Industrial Average dropped 652 points to 34,484, dragged down by losses in American Express and Salesforce. The S&P 500 shed 1.9% to 4,567. The technology-heavy Nasdaq Composite dipped about 1.6% to 15,538. The small-cap benchmark Russell 2000 dropped 1.9% to 2,199 as economically sensitive names like SeaWorld got hit hardest. Overall the market anticipated a return to the norms of early 2020 given Omicron's emergence.

The stock market reversal on 30 November also came after Moderna CEO Stephane Bancel told the Financial Times that he expects existing vaccines to be less effective against the new variant. The CEO told the newspaper there could be a "material drop" in the current vaccines' effectiveness against this variant. Bancel told that it could take months to develop and ship an Omicron-specific vaccine. Moderna dropped about 4.4% on this news.

Fixed Interest

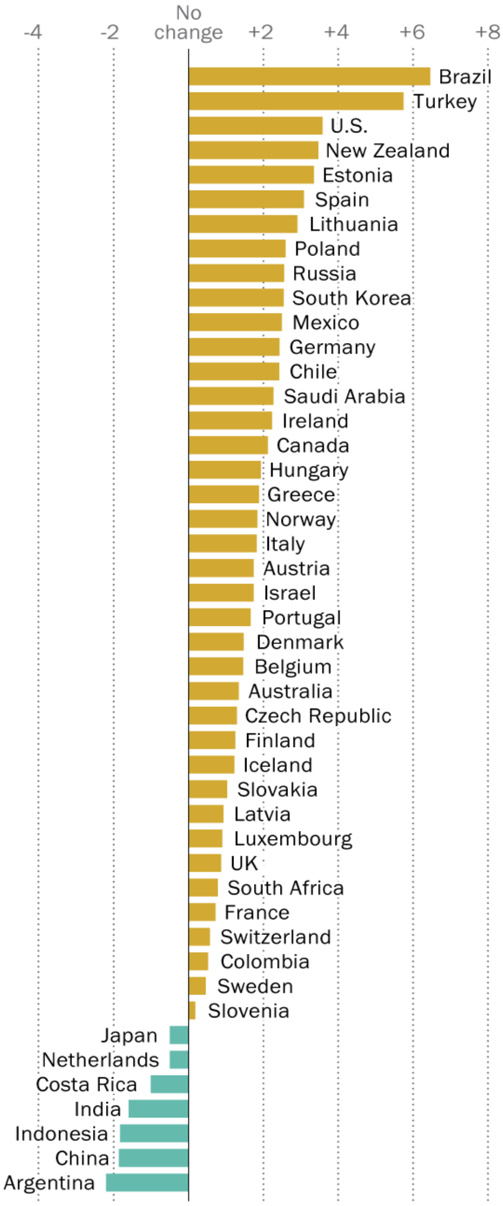
US bond yields were mixed and the curve flattened as markets digested Powell's inflation comments and the possibility of a faster Fed taper on the backdrop of rising virus concerns. 2 year government bond yields rose from 0.44% to 0.55%, and the US 10 year yields fell from 1.50% to 1.41% before settling at 1.45%.

INFLATION

But if you've been to the grocery store lately and noticed how expensive groceries are, it's not just you – and it's worse in America. A Pew Research Center analysis of data from 46 nations finds that the third-quarter 2021 inflation rate was higher in most of them (39) than in the pre-pandemic third quarter of 2019. In 16 of these countries, including the US, the inflation rate was more than 2 percentage points higher last quarter than in the same period of 2019 (Figure 3).

With inflation up, the Fed needs to reduce quantitative easing, or in Jerome Powell's words "consider wrapping up the taper of our asset purchases … perhaps a few months sooner," as stated in an appearance before a Senate Committee on 30 November. Powell's other comments suggested that the Fed's focus has now changed to fighting inflation and its negative impacts rather than on resilience to potential disruptions in economic activity from new variants of Covid.

Figure 3: Inflation has risen in many countries, but rarely as much as in the US.



Change in annual inflation rate between third quarter of 2019 and third quarter of 2021 in percentage points. Source: Pew Research Center

But the recent acceleration in the rate of inflation appears to be fundamentally different from other inflationary periods that were more closely tied to the regular business cycle. Explanations for the current phenomenon proffered to date include continuing disruptions in global supply chains amid the coronavirus pandemic and turmoil in the labour markets.

How will those who changed course during the Great Resignation fare? Well, a lot of them will receive increased wages elsewhere, and over 2.75 million of them will be over 55 and heading towards retirement, a financial situation where inflation shows its teeth. With the statistics in we have seen that wage growth is highly correlated with the rate of resignations, so those who do get back into the workforce and receiving more disposable income to invest.

GEOPOLITICS

Russia/Ukraine tensions are in the headlines again. Nearly 100,000 Russian troops, as well as tanks, artillery, and even short-range ballistic missiles, have been built up within striking distance of Ukraine's borders. The estimated number of Russian troops available for operations against Ukraine from bases or staging areas within 250km operational distance of Ukraine's borders increased from 92,000 to 115,000 troops in two weeks, says Andy Scollick, a Defence and Security Analyst specialising in the area.

Vladimir Putin has warned NATO countries that deploying weapons or soldiers to Ukraine would cross a "red line" for Russia and trigger a strong response, including a potential deployment of Russian missiles targeting Europe. In particular, he warned against the stationing in Ukraine of missile defence systems similar to those in Romania and Poland. Putin claimed they could serve as cover to deploy offensive weapons such as Tomahawk missiles, which are capable of reaching Moscow in minutes.

"We would have to create a similar threat for those who are threatening us," he said, warning that Russia could deploy hypersonic missiles. Putin's remarks seemed designed to echo the fears of Europe's cold war missile crises. NATO countries such as the United States have supplied Kyiv with military aid, including lethal weapons like Javelin anti-tank missiles. But aside from isolated discussions among lawmakers, there are no plans to station air defence batteries in Ukraine.

The Northern Hemisphere moving into winter continues to create an uneasy power dynamic for Europe. Russia has a great deal of military experience in severe cold conditions, and the onset of winter has spelled the end for several invading armies. Nowadays, Russia has its gas pipeline. The country that holds the energy source, holds the power.

China/US tensions also intensified in November. Relations with the US remained tense over the status of Taiwan and trade issues. The US Commerce Department issued a trade blacklist naming a dozen Chinese companies that it said supported the military modernisation of the People's Liberation Army. In response, a Chinese official said the US should not expect China's military to compromise regarding Taiwan.

In a separate development, the US Federal Communications Commission (FCC) asked a federal appeals court to reject China Telecom's bid to continue providing services in the US, arguing that China Telecom's ownership allows Beijing to access and possibly disrupt or misroute US communications. The FCC's action followed its designation of China's Huawei Technologies and ZTE Corp as US national security threats last year. Reports that China's tech watchdog has asked the management of China's ride hailing app Didi Global to delist the company from the New York Stock Exchange due to data security concerns shows the mistrust, and knack for public gestures, goes both ways.

OMICRON – NEW VARIANT

On 26 November, WHO designated the variant B.1.1.529 to be one of concern, named Omicron, on the advice of WHO's Technical Advisory Group on Virus Evolution (TAG-VE). This decision was based on the evidence presented to the TAG-VE that Omicron has several mutations that may have an impact on how it behaves, for example, on how easily it spreads or the severity of illness it causes. Here is a summary of what is currently known.

It is not yet clear whether Omicron is more transmissible compared to other variants, including Delta. The number of people testing positive has risen in areas of South Africa affected by this variant, but epidemiologic studies are underway to understand if it is because of Omicron or other factors.

It is also not yet clear whether infection with Omicron causes more severe disease compared to infections with other variants, including Delta. Preliminary data suggests that there are increasing rates of hospitalization in South Africa, but this may be due to increasing overall numbers of people becoming infected, rather than a result of specific infection with Omicron. There is currently no information to suggest that symptoms associated with Omicron are different from those from other variants. Initial reported infections were among university students, younger individuals who tend to have more mild cases, but understanding the level of severity of the Omicron variant will take several weeks.

Several regions including the US, EU, and the UK have implemented travel restrictions. Omicron's effect on the global economic recovery is still unclear. Goldman Sachs predicts that in a downside scenario, global growth in the first quarter could decline to 2%, or 2.5% below projections. In an upside scenario, the global economy could outpace projections and see inflation decline if Omicron spreads more easily but is less severe.

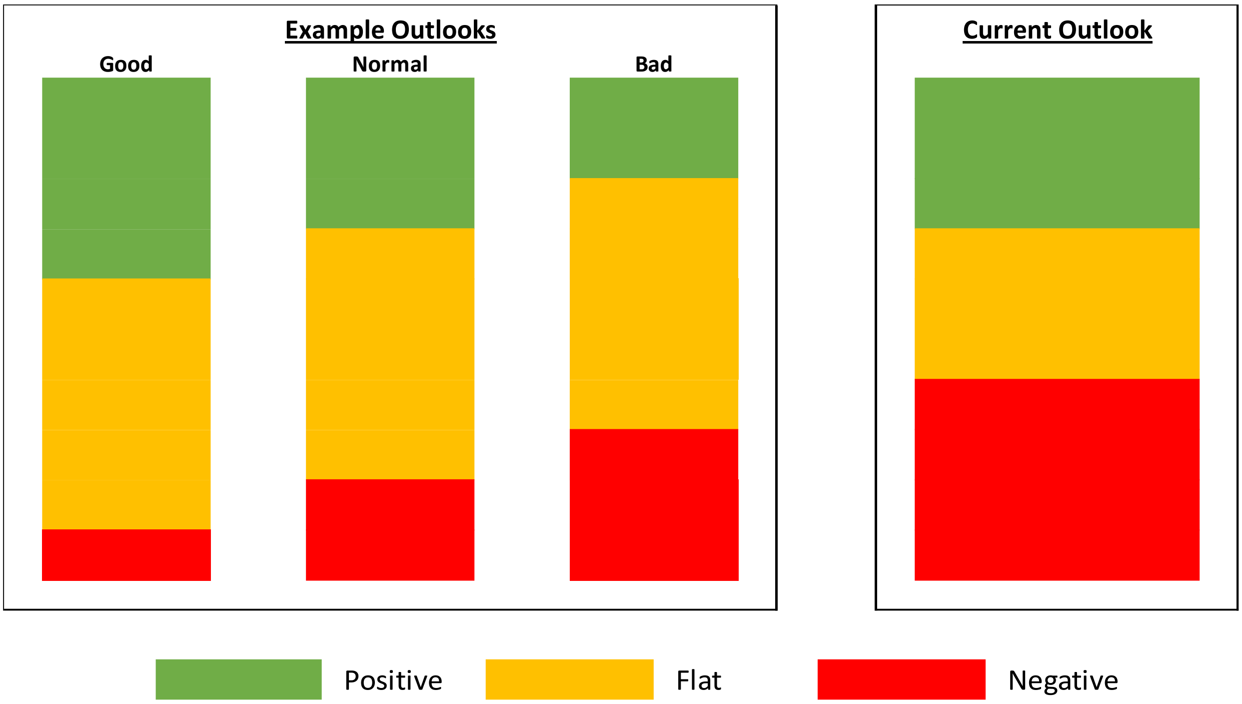
"LITHIUM LIGHT" RENEWABLES

The race is on to replace lithium-ion batteries. Researchers in the US, Japan, China and the EU are focused on several alternatives – but they may not be available for more than a decade. Batteries power everything from our phones to electric vehicles (EVs), but existing battery technology cannot store the electricity that will be required as we move toward renewable energies. Demand for EVs could also increase demand for clean energy by 1.1 million Gigawatt hours. As a result, global energy storage is set to hit 1 Terawatts hours by 2030, which is 20x the levels of 2020 and could cost around US$262 billion in additional investment.

Here's some updates on new developments in the battery space:

- Scientists in the EU are focused on environmentally-friendly rechargeable magnesium batteries that could store 1,000 watts of energy density — 2x the level of the first lithium-ion battery introduced in 1991. However, professors at Japan's Tohoku University believe a zinc-ion battery has a reduced risk of fire hazard and can store electricity from renewable energy sources.
- Chinese battery company CATL unveiled its first-generation sodium-ion battery. Sodium is abundant, less expensive and the batteries are non-flammable, so CATL plans to ramp up production by 2023.
- Japan will spend $877M on subsidies for advanced battery factory construction as part of its push to develop 100 GWh of domestic battery storage capacity to power 2.4M EVs by 2030.
- Japan's Sumitomo Metal Mining will start recycling cobalt and lithium from used EV batteries that could be competitive even if lithium prices fall from $30/kg to $5/kg.
- Automakers like Tesla, Ford and VW see lithium-iron-phosphate (LFP) batteries as a cheaper alternative to cobalt as most of the world's cobalt reserves are located in the Congo, where the mining sector is associated with human rights violations.

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 increased marginally compared to the last one we had.