

# ERIKSENSGLOBAL

Actuaries & Investment Strategists

## MARKET PERFORMANCE AND COMMENTARY – MARCH 2022

### MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	7088.65	3.1	-4.6	11.6
MSCI World NR (NZD)	13303.11	-0.03	-6.6	10.9
MSCI Emerging Markets	697.62	-2.06	-6.1	-9.9
S&P 500 (US)	4530.41	3.6	-4.9	14.0
Nikkei 225 (Japan)	27821.43	4.9	-3.4	-4.7
FTSE 100 (UK)	7515.68	0.8	1.8	11.9
DAX (Germany)	14414.75	-0.3	-9.3	-4.0
CAC 40 (France)	6659.87	0.0	-6.9	9.8
Trans-Tasman Equities				
S&P/NZX 50	12110.26	1.1	-7.1	-3.6
S&P/ASX 300	87474.30	6.9	2.1	15.2
Bonds				
S&P/NZX NZ Govt Stock	1735.41	-2.5	-4.3	-7.1
S&P/NZX A Grade Corporate	5542.35	-1.6	-2.9	-5.2
Barclays Global Agg (Hedged to NZD)	405.30	-2.1	-4.8	-3.6
FTSE WGBI (Hedged to NZD)	3497.72	-2.1	-4.6	-3.7
Oil				
West Texas Intermediate Crude	100.28	4.8	30.3	69.5
Brent Crude	106.60	5.7	37.6	70.8
NZD Foreign Exchange				
AUD	0.9262	-0.7	-1.6	0.7
EUR	0.6251	3.8	3.8	4.9
GBP	0.5283	4.7	4.5	4.1
JPY	84.4224	8.3	7.1	9.1
CNY	4.4154	3.4	1.4	-3.9
USD	0.6956	2.8	1.6	-0.7

Source: Nikko, indices are in the local currency of the asset unless otherwise indicated.

Executive summary:

- Geopolitical risks are still high
- Supply chain disruptions have worsened
- Equity markets slightly recovered losses in March
- Oil prices stabilised around \$100 per barrel
- New Zealand dollar appreciated against main currencies, except the Australian dollar

ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

The main themes during the month were the war in Ukraine, inflation and tightening monetary policy.

Russia has continued its invasion of Ukraine for more than a month now, despite the many sanctions imposed against President Putin. Ukraine is holding up with help from the US and Europe although the war has cost the lives of thousands of people, and approximately USD63b of damaged infrastructure.

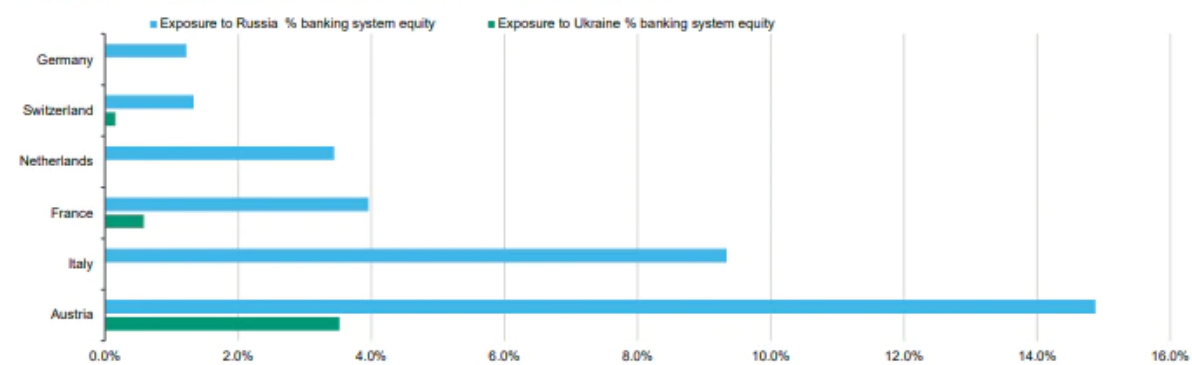
The Federal Reserve increased interest rates for the first time since 2018, responding in part to the effect of higher commodity prices on inflation. The Bank of England, also trying to tackle inflation, raised interest rates for the third time in the last four months, from 0.5% to 0.75%. The European Central Bank kept interest rates at 0%, however it is accelerating towards the end of its quantitative easing programme.

China is continuing its zero-tolerance coronavirus policy and locking up cities after facing its biggest COVID-19 outbreak since the beginning of the pandemic. China has also signalled a potentially major shift in its economic policies including easing regulatory crackdowns, supporting property developers and stimulating the economy through monetary policy.

The sanctions against Russia are hitting the European banks, insurance and lease companies (Figure 1). According to the European Banking Authority, exposures to Russia and Ukraine stand at around €90 billion. Italian UniCredit, French Societe Generale and Austrian Raiffeisen have the notable presence in Russia and Ukraine and for UniCredit alone the possible loss could reach €7 billion. Lease companies with exposure can expect to see total losses of \$10 billion from the 500+ planes currently grounded in Russia.

Figure 1

European banks' exposure to Russia and Ukraine is low with a few exceptions



Data as of 30 September 2021

Sources: Bank for International Settlements (BIS) and respective central banks.

Source: Moody's Investors Service

Source: Reuters.com

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## LOCAL SNAPSHOT

It was a rocky month for many New Zealand businesses, and confidence about the economic outlook has fallen to low levels. Key among the challenges that businesses are grappling with has been the sharp rise in operating costs, which is squeezing margins. There are also changes afoot on the migration front, and difficulties sourcing staff are likely to continue for some time yet.

The New Zealand government lifted the vaccine mandates for several sectors effective from 4 April although mandates will be ongoing for aged care and health sectors and border workers. This is a huge relief for the hospitality industry which was severely impacted by the mandates. However, household spending on hospitality and entertainment remained below the levels reached before last year's Delta outbreak, despite a less restrictive operating environment.

New Zealand's borders open for Australian citizens from 12 April and for visa waiver countries from 1 May. Business owners are hoping that the opening border could ease the skilled labour shortage, but it is likely to be a challenge. Talented New Zealanders are already looking for opportunities abroad and are ready to move.

New Zealand's GDP rose by 3% in Q4 2021 which was lower than analysts expected but higher than the RBNZ's forecast. Activity rebounded strongly in the goods-producing sectors, but many in-person services saw further declines.

The minimum wage increased to \$21.20 an hour from 1 April, triggering another round of wage raises and adding pressure to labour markets that will drive inflation up more.

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## WORLD FINANCIAL MARKETS

### Equities

MSCI All Country World Index (MSCI ACWI) rose 2.2% in March and the S&P 500 returned 3.7% in March closing out its best month since December but its worst quarter since early 2020. Cyclically sensitive stocks underperformed as investors braced for a slowdown in growth, particularly the financial services and industrials sectors in the S&P 500. Higher interest rate expectations also pulled down prices in the information technology sector, while the typically defensive consumer staples and utilities sectors outperformed.

The S&P/ASX 200 extended its February gains into March, adding 7% to close the quarter in positive territory. A more upbeat rhythm over the last two months means that this Australian bellwether is within striking distance of its August 2021 all-time high. Just a 2% gain would make a new record closing level.

Micro-cap names in Australia surged the most, as the S&P/ASX Emerging Companies Index jumped 11% in March following a retreat earlier in the year, to close the quarter in the black. New Zealand equities ended higher in March, although the last-minute sprint wasn't enough to erase capital losses in the year to date.

In Australia only four out of 11 GICS (Global Industry Classification Standard) sectors contributed positively to the S&P/ASX 200's quarterly return. Energy took the top spot, soaring 29% thanks to higher crude oil prices, while the runner-up was materials at 15% and third-place went to utilities, rising 14%. Information technology was the best performer in March, but was fourth over the quarter, weighed down heavily by AfterPay and Xero.

### Fixed Interest

The US 10-year Treasury yield ended the week down 9 basis points at 2.39%. While prices of US Treasuries rose for the last week of the month, the Bloomberg US Aggregate Bond Index rounded out its worst quarter since late 1980, and its third-worst quarter since the index's inception. March was the worst monthly performance for the index since July 2003. Portions of the Treasury yield curve inverted over the week, but the correlation between an inversion and a looming recession may not necessarily hold (according to the analysts), as investors appeared to be favouring longer-dated treasuries due to signals that the Federal Reserve may hike official short-term rates by 50 basis points in May.

Core eurozone bond yields fluctuated over the week but ended the period roughly level. Higher-than-expected inflation data boosted expectations for further interest rate increases and drove yields higher. But yields fell again as optimism over Russian-Ukrainian peace talks faded. ECB chief economist Philip Lane said the ECB should be ready to revise policy should macroeconomic conditions deteriorate significantly.

UK gilt yields fell in line with US Treasuries, which declined on geopolitical tensions and fears of a recession. The UK 10-year gilt yield ended the week eight basis points lower, down from 1.69% to 1.61%.

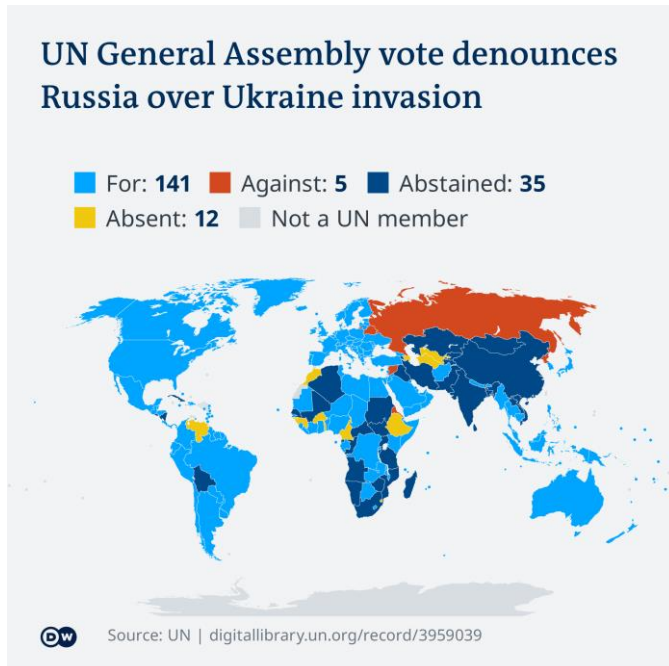
## GEOPOLITICS

Geopolitics has remained at the top of the headlines since Russia invaded Ukraine in February. The war has forced Ukrainians to flee to neighbouring countries in Europe. According to the UN Refugee Agency, approximately four million people (mostly women and children) have left Ukraine. This is the biggest conflict in Europe since Kosovo during 1998 and 1999. However, the world's media is silent about the no-less heart-breaking situation in Ethiopia with more than 500,000 civilian and military casualties since November 2020, driven by a rebellion against the government. This has been ongoing since the mid-1970s, but again erupted into open conflict in late 2020. In contrast, Ukraine's President Zelensky has been incredibly vocal, speaking up through numerous European and global channels which has put the spotlight on his country's plight.

There have been several rounds of negotiations between Russia and Ukraine. Still, very little has been achieved in terms of establishing green corridors for the evacuation of civilians from southern and eastern cities of Ukraine. The arrangement towards the end of March failed after the convoy was shot at, with each side blaming the other for the shooting.

Since the start of the war, 141 countries have condemned the Russian invasion (Figure 2). Most interestingly the two biggest countries by population, China and India, have abstained from voting. China has its own territorial issues with Taiwan and Tibet and, in practice, should vote against separatism and any military actions supporting that.

Figure 2



Source: *dw.com*

Although China's stance is clear, the position of India has puzzled many. India's biggest trade partner is the US, however Russia is their main supplier of defence and military equipment. India is a member of QUAD (Quadrilateral Security Dialogue) alongside the US, Japan and Australia, but historically was supported by the USSR and Russia in Indo-Pakistan conflicts. The USSR backed India during the war with Pakistan in 1971 when the US Navy was about to hit Indian Army facilities but was stopped by Soviet submarines. India is standing on the edge of choice between their economy and national security.

North Korea have continued their military program with the launch of a Hwasong-17 intercontinental ballistic missile that was in air space for more than an hour and, if directed to, could reach the territory of the US. This step changed the risk level from possible to real for the US and shifted the balance of power to North Korea. Iran bombed the US consulate in the North Iraq province Erbil, not helping the nuclear deal abandoned by the Trump administration in 2018. Azerbaijan entered the "demilitarized" Nagorno Karabakh region where Russian peace-making troops were dislocated as per a trilateral agreement among Azerbaijan, Armenia and Russia. Armenia has stated that Azerbaijan violated the terms of agreement.

The Chinese Air Force and Navy are also testing Taiwanese defences, in a clear provocation.

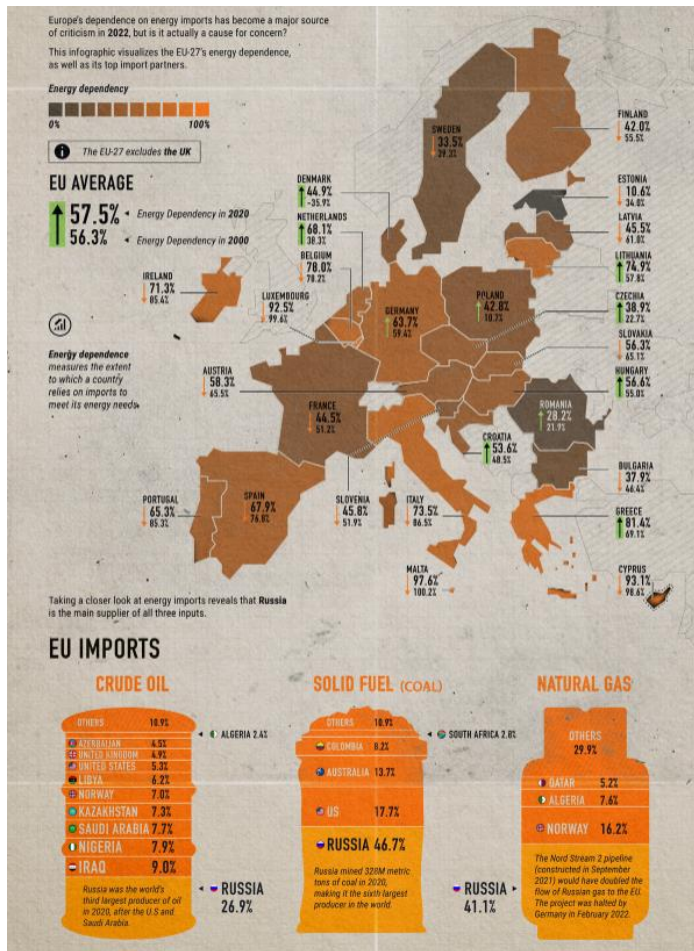
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## GLOBAL SUPPLY CHAIN – DRIVE, EAT AND GROW

A range of sanctions were triggered in response to the Ukraine invasion from the US, Europe and allies. One of these was the ban of imported energy resources from Russia by the US and UK and reducing the volumes from the EU. The US is less dependent than Europe on Russian oil, with the latter having increased its energy dependence from Russia to 57.5% (Figure 3). Even with increased supply from the US, Norway, and Qatar there is no way to completely stop the import of Russian oil and gas in the short term. Rising oil and gas

prices brought protesters to the streets of Marseille in France, as well as in Italy and Spain, where locals are already suffering from record inflation.

Figure 3



Source: visualcapitalist.com

Analysts think fears of future disruptions are likely to incentivise investment in localised production and shoring up of supply chains, including improvements in agricultural yields. But these improvements will only be realised over the mid- to long-term.

The U.N. World Food Programme gets half its wheat supply from Ukraine and is already looking at alternative sources for its aid distributions as countries anticipate lower supply (Figure 4). Since Russia has banned the export of its agricultural products, and Ukraine cannot ship wheat (or corn) due to the Russian Navy blocking their seaport, there is now the threat of massive starvation in both Asia and Africa. This is already affecting global prices for wheat, corn, and soy.

Figure 4



Source: *dw.com*

The future of humanity obviously depends on our ability to produce enough food, and agriculture at scale relies on fertiliser. Russia and Belarus contribute significantly to global fertilizer production, but prolonged sanctions and disruptions to grain and fertilizer volumes will mean reduced crop yields at a time when food prices are already setting new records as measured by the Food and Agriculture Organization.

Brazilian farmers are already reducing corn plantings due to rising fertilizer prices, and globally a 8% decrease in corn harvest this year is expected. Before the sanctions, fertiliser prices were already rising as the pollution and carbon cost of fertiliser and agriculture were priced in. Now Thailand is facing pressures on its rice crops, as Russia and Belarus supplied a tenth of its fertilizer imports in 2021.

China already imposed fertilizer export curbs last year to protect its own farmers when global prices rose due to strong demand and high energy prices. It is unknown whether restrictions will be lifted anytime soon.

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## SODIUM IS THE NEW LITHIUM

A crucial discovery by US researchers could make sodium-ion batteries safer and more affordable with a greater range than lithium-ion batteries. With plans in development, Tesla could be one of the first EV makers to utilize sodium-ion batteries as their function improves. Since sodium-ion batteries are made using the exact same process as lithium, their time to market could be faster than other alternatives and at a much cheaper cost.

Sodium is coveted by battery manufacturers due to the material's greater abundance and lower cost compared with lithium. Plus, lithium is more flammable. However, sodium's commercialisation has been delayed due to its rapid performance decline. But for the first time, Argonne National Lab scientists were able to watch in real-time how the atomic structure of the cathode material degraded as it was rapidly

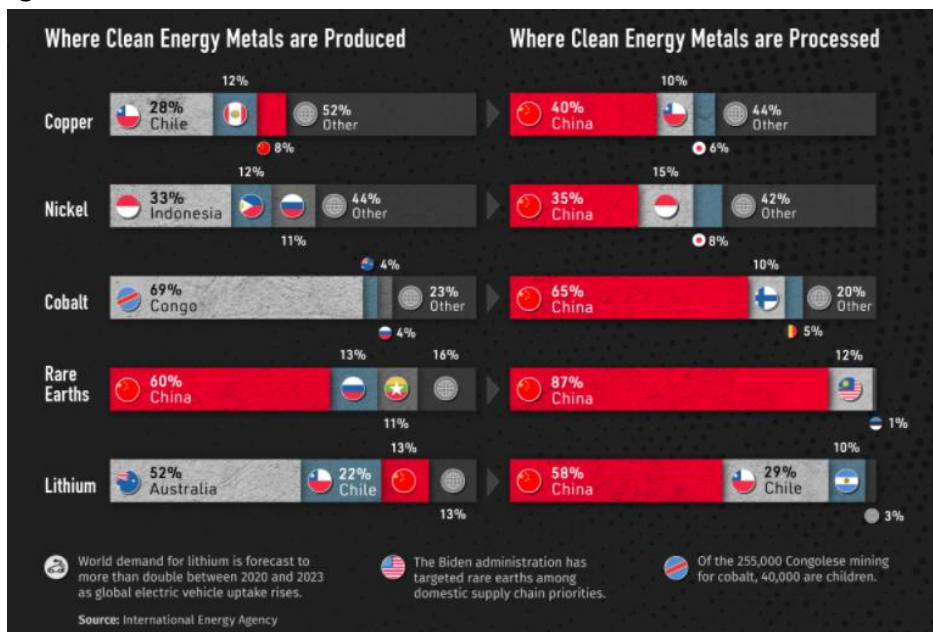
cooled. With improvements to the manufacturing process, this discovery could lead to a 20% to 40% increase in battery performance.

Chinese battery maker CATL has 32% of the EV battery market share and is a major supplier of batteries to Tesla and VW. CATL will put a sodium-ion battery production line into operation by next year. CATL's solution for sodium's performance challenge was to develop a hard carbon anode material that allows for more storage and fast movement of sodium ions. The firm says at room temperature, the battery can charge to 80% in 15 minutes.

India's Reliance Industries has acquired UK-based start-up Faradion, known for its sodium-ion tech, for \$136 million to compete with CATL. Both Reliance and CATL aim to reach an energy density of 200Wh/kg in their next generation of sodium-ion batteries. The price to produce sodium-ion batteries is typically 20% to 40% cheaper, which also increases their appeal. But as raw material prices skyrocket, experts believed the point at which EV costs will compete with internal combustion vehicles could be pushed back to 2026.

The development of sodium-ion batteries might undermine China's lead as a producer of electric batteries for car makers and decrease dependence on China-processed lithium, cobalt, and nickel (Figure 5).

Figure 5



Source: [visualcapitalist.com](https://www.visualcapitalist.com)

## NEW WORLD ORDER?

Russia's invasion of Ukraine has uncovered a range of global security problems, spanning the areas of energy, food, data, national defence, and climate. Experts expect heightened international mistrust to spur governments and corporations to put greater emphasis on security and stability over price and efficiency.



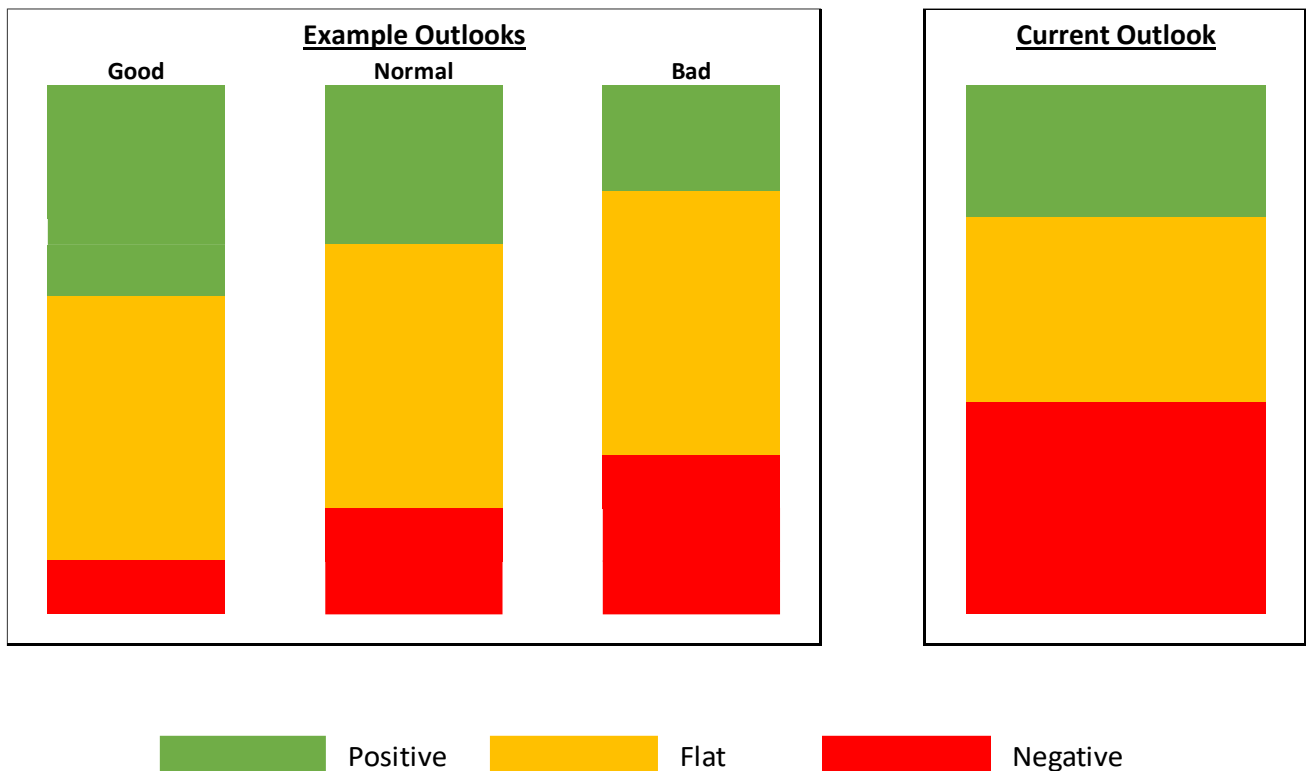
China is using the current situation to its own benefit and increasing its influence. China supports indirectly blaming NATO for its expansion and playing with Cold War definitions. In exchange Russia supply energy resources at a discount to support the growth of stalled Chinese economy.

Chinese steelmakers are pushing the use of yuan in international transactions in addition to Sino-Saudi negotiations for oil payments in yuan. If China and Saudi Arabia agree, it would be another step towards global de-dollarisation.

The second biggest Asian country, India, is also using the current situation to get discounted Russian oil. Russia is reviving rouble-rupee transactions that were first used in 1953 and common throughout 1970-1990s. This arrangement will help Indian exporters take the place of western companies which left the Russian market, as per the Federation of Indian Export Organisations.

With all the risks it pays countries to develop their own internal sources of supply and industries. Globalisation could well unravel under these political pressures.

**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 more likely to have a bad return (red).