ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – MAY 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,793.4	-0.2	3.9	3.2
MSCI World NR (NZD)	14,460.0	2.0	7.3	10.9
MSCI Emerging Markets	640.3	-1.0	0.4	-4.7
S&P 500 (US)	4,179.8	0.2	5.3	1.2
Nikkei 225 (Japan)	30,887.9	7.0	12.5	13.2
FTSE 100 (UK)	7,446.1	-5.4	-5.5	-2.1
DAX (Germany)	15,664.0	-1.6	1.9	8.9
CAC 40 (France)	7,098.7	-5.2	-2.3	9.7
Trans-Tasman Equities				
S&P/NZX 50	11,813.0	-1.7	-0.7	4.5
S&P/ASX 300	86,344.3	-2.5	-1.0	2.4
Bonds				
S&P/NZX NZ Govt Stock	1,693.2	-0.9	2.5	-0.2
S&P/NZX A Grade Corporate	5,592.0	-0.1	2.3	2.2
Bloomberg Global Agg (Hedged to NZD)	386.3	-0.4	2.3	-1.8
Oil and Gold				
West Texas Intermediate Crude	68.1	-11.3	-11.6	-40.6
Brent Crude	72.0	-11.5	-12.7	-39.9
Gold	1,962.7	-1.4	7.4	6.8
NZD Foreign Exchange				
AUD	0.93	-0.9	0.8	2.1
EUR	0.56	0.5	-3.7	-7.5
GBP	0.48	-1.6	-5.5	-6.4
JPY	83.72	-0.4	-0.8	0.0
CNY	4.27	-0.1	-0.8	-1.8
USD	0.60	-3.0	-3.2	-7.9

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

Executive summary:

- Equities had mixed results in May due to the uncertainty of US debt ceiling negotiations.
- Bond yields rose on expectations of further interest rate hikes by major central banks.
- Oil fell below $80/per barrel due to weak demand in China, Europe and the US.
- Geopolitical tensions are still high. Deglobalisation is accelerating.
- The NZD depreciated against all major currencies except the EUR.

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ECONOMIC COMMENTARY

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9 June 2023

GLOBAL SNAPSHOT

US President Joe Biden and House Speaker Kevin McCarthy have struck a deal to raise the debt ceiling and avert a government default. The deal, to raise the debt ceiling for two years, must still be approved by the Senate. The deal was not popular with either party, but both will need to persuade their lawmakers to vote for it. The US Congress agreed to increase the country's debt limit on 2 June, avoiding a potential default on its financial obligations.

Earlier in May, financial markets sentiment was against the Fed increasing the cash rate, yet economic data released since the increase shows consumer demand is still strong. Most analysts, though not unanimously within our team, expect a further rate hike in July. Key data points supporting another hike include personal consumption expenditure (PCE) rising 0.4% in April, personal spending up 0.8%, wage income increasing 0.5% and core PCE inflation rising 4.7% in April, which is still above the Fed's target of 2%. Fed Chair Jerome Powell hinted at a pause in the central bank's tightening cycle, but he has stressed that assessments will be made "meeting by meeting" based on incoming data. The Fed is more likely to raise interest rates in July if economic data is strong and high inflation persists. While the decision will ultimately be based on incoming data, even though the cumulative impacts of current interest rates won't be felt until 2024 and beyond.

Market confidence in Fed Chair Jerome Powell has declined in recent months. A recent poll by Gallup found that only 36% of Americans have a great deal or quite a lot of confidence in Powell, down from 58% at his peak (Figure 1). The decline in confidence is due to a number of factors, including:

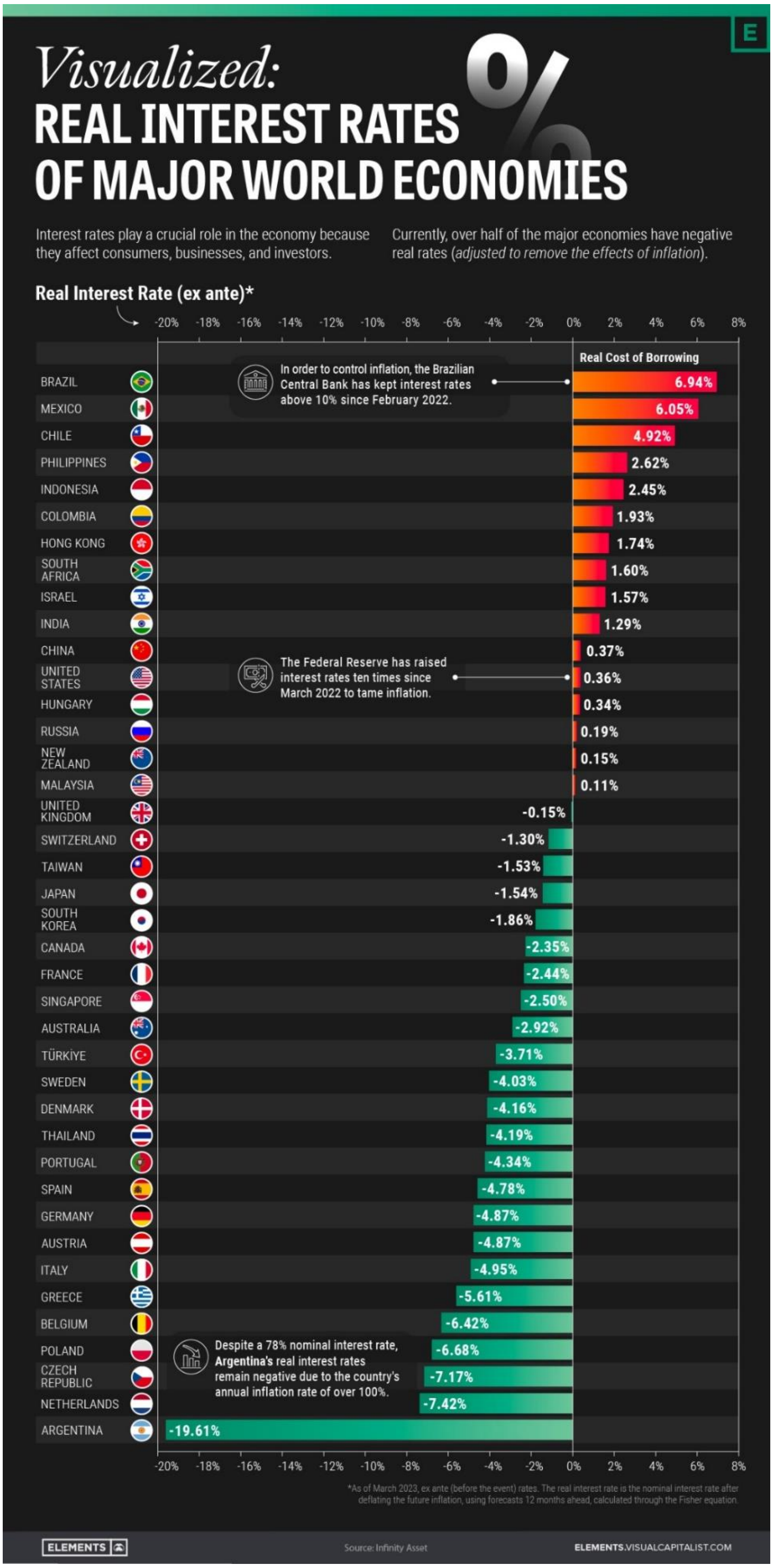
- A mismatch between the Fed Chair's speeches and the interpretation by investors. Some investors believe that Powell's speeches have not been clear enough about the Fed's plans for the future.
- The Fed's handling of the economy. Some economists believe that the Fed has been too slow to raise interest rates in response to rising inflation.
- The Fed's quantative easing program. Others believe that the Fed's quantative easing program has inflated asset prices, making the market more vulnerable to a crash.

Figure 1

Source: visualcapitalist.com

Inflation and monetary policy tightening have recently led to rapid increases in nominal interest rates in many countries. The International Monetary Fund (IMF) believes that these increases could be temporary. However, the IMF also warns that there is a risk that inflation could become more entrenched if central banks do not act to tighten monetary policy further. In this case, interest rates may need to remain higher for a longer period of time to bring inflation under control. Current real interest rates in most developed countries show that there is still a long way to go to curb inflation (Figure 2).

Figure 2



Source: visualcapitalist.com

LOCAL SNAPSHOT

The New Zealand government's Budget 2023 focuses on increased borrowing rather than reprioritised spending. Key highlights include extending early childhood education to include 2-year-olds, abolishing the $5 prescription co-payment and cheaper public transport for children. The Budget also allocates $71 billion for infrastructure spending. The capital allowance is expanding by $20.5 billion over the next four years, including $6 billion for a National Resilience Plan. Operational expenditure will increase by $4.8 billion in the next year. To fund this additional expenditure, the Treasury plans to issue $120 billion of New Zealand Government Bonds over the next four years, $20 billion more than forecasted in December. The bond issuance program is affected by factors such as the unwinding of the Reserve Bank's Large-Scale Asset Purchase program and the need to refinance debt issued during the pandemic. The New Zealand dollar and debt market remained relatively stable after the Budget announcement.

In May, the RBNZ raised the Official Cash Rate by 25 bps to 5.5% while stating that it views this as the highest point for the OCR and expects to implement rate cuts starting in the third quarter of 2024. This more cautious and accommodative stance from the RBNZ took the market by surprise, as it was seen as a softer and more "dovish" approach. The increasein immigration figures and the recent Budget announcement had caused market forecasts to shift significantly since the previous OCR decision made in April.

In the year ending March 2023, New Zealand experienced a significant net migration gain of over 65,000 people, marking a remarkable turnaround from the net loss recorded the previous year. However, a considerable number of New Zealanders chose to leave the country, resulting in a net migration loss of 23,500 citizens, the highest since October 2013. But migration in 2022 was negative (-93,919), and for 2021-2022 net migration was -142,027. So this new inflow only reduces the net negative migration experienced over the last two years. At the same time, New Zealand is experiencing a "brain drain" as more Kiwis move to Australia, pursuing higher wages and a new pathway to citizenship. According to the Australian Bureau of Statistics, a 42% quarter-to-quarter increase in migration to Australia was recorded in March 2023. Including our own administrator Rochelle Ridgway, who now works remotely from Adelaide!

WORLD FINANCIAL MARKETS

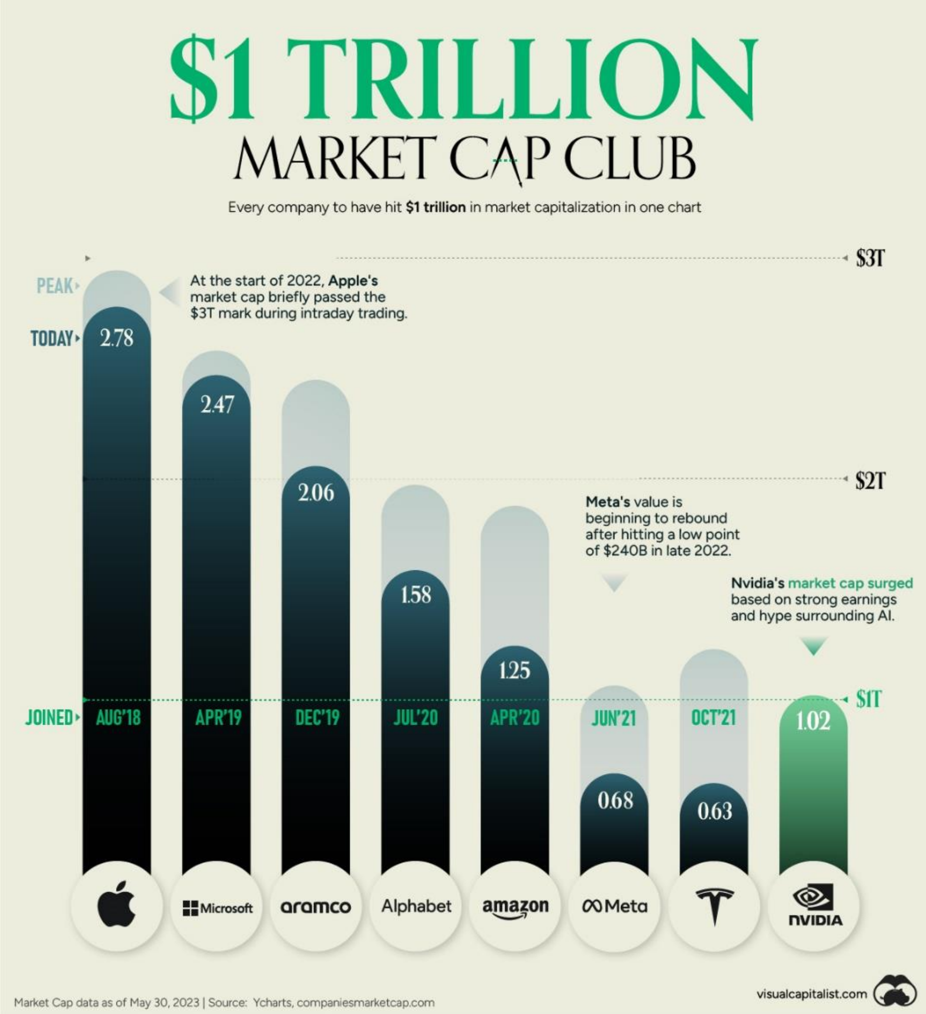
Equities

The MSCI World Index was down 0.2%, and MSCI Emerging Markets returned -1.0% in May in local currency terms.

The S&P 500 Index closed up by 0.4% in May. The major benchmarks were mixed as investors watched carefully for signs of progress in negotiations over raising the US federal debt ceiling. The technology-heavy Nasdaq Composite outperformed, rallying 5.8% for the month.

NVIDIA's shares jumped 24% in May, taking the company's market capitalisation to $1 trillion, and making it the sixth most highly valued public company in the world (Figure 3). Shares rose after the company beat consensus first-quarter earnings expectations by a wide margin and raised its profit outlook.

Figure 3



Source: visualcapitalist.com

In Europe, the MSCI Europe ex UK Index fell 3.1% on signs that the economic outlook may be worsening and continued uncertainty over US debt ceiling talks. Major stock indices also weakened. Germany's DAX Index slid 1.6%, France's CAC 40 declined 1.5%, and the UK's FTSE 100 was down 5.4%.

Australian large caps lost ground in May, falling 2.5%. This erased their gains for the quarter and then some. Mid caps outperformed, while small caps lagged their blue-chip peers. The S&P/ASX 200 IT sector was the best performer in May, up 11.6%, while consumer discretionary lagged, down 6.1%.

Chinese stocks fell after a batch of disappointing indicators in recent weeks pointed to a flagging economic recovery. The Shanghai Stock Exchange Index lost 3.6%.

Fixed Interest

Short-term US Treasury yields rose sharply in the week ending 26 May, as investors grew more confident in the US economy and worried about the federal debt ceiling. The yield on the two-year note, which is sensitive to interest rate expectations, hit its highest level since March. The yield on the one-month Treasury

bill, which is sensitive to short-term funding pressures, hit its highest level since its introduction in 2001. The US 10-year Treasury yields moved lower to 3.65%.
European government bond yields rose as investors grew more concerned that central banks would continue to raise interest rates to combat inflation. The yield on the benchmark 10-year German bund, which is seen as a safe haven asset, increased to 2.54%.

In the US investment-grade corporate bond market, the front-loaded week of issuance was adequately subscribed to before new issues slowed down before the long weekend, while regional bank issues continued to rebound.

GEOPOLITICS

Turkish President Recep Tayyip Erdogan won a landslide victory in the country's presidential election, securing a fifth term in office. Domestically, Erdogan is facing an economic crisis. Inflation is at an all-time high and the Turkish lira has lost a lot of its value. Erdogan's economic policies have been blamed for the crisis. Internationally, Erdogan is facing criticism for his human rights record. He has been accused of cracking down on dissent and of imprisoning journalists and opposition leaders. Erdogan has also been criticised for his close ties to Russia. However, Erdogan's re-election reduced the risk of further escalation of anti-Russian sentiment in the region and left room for Turkey to play a mediation role in Russian-Ukrainian tensions.

The joint statement of the Hiroshima G7 summit emphasises the importance of economic resilience and security, advocating for the diversification and de-risking of supply chains instead of pursuing complete decoupling, which indicates an acknowledgment of the impracticality of severing economic ties with China. By stepping back from the rhetoric of decoupling, not only does this approach serve the interests of the United States, but it also allows Europe and Japan to maintain their crucial economic connections with China. However, the opposite may be true, as China expressed its concern over Japan's recent (from March 2023) imposition of restrictions on the export of chipmaking equipment, stating that it would negatively impact the economic and trade relations between the two nations. China strongly disagrees with Japan's decision, considering it a violation of international economic and trade rules. The statement also reaffirms the commitment to a free and open Indo-Pacific and opposes any unilateral attempts to change the existing order through force or coercion, specifically addressing China's threats towards Taiwan.

The G7 declaration also highlighted the disconnect between ideals and actions, as well as the disparity between words and actuality. The choice of Hiroshima as the summit location sends a perplexing message, considering it was the tragic target,of the only instance in which nuclear weapons were used against a civilian population during war. Given this historic context, Hiroshima should have served as a platform to promote global peace and specifically prevent any nuclear-related conflicts from escalating. However, the decision to invite President Volodymyr Zelenskyy and provide military support and financial aid to Ukraine undermines the peace-oriented message. The summit failed to produce any significant peace initiatives, instead offering indefinite support to Ukraine, raising questions about its realistic goal of achieving either a partial or complete military defeat of Russia.

Meanwhile, China is increasing its leadership in the developing world. The recent China-Central Asia Summit held in Xi'an in mid-May had significant geopolitical implications, overlapping the G7 summit in Hiroshima. The key disparities between the two summits lay in their focus and substance. The China-Central Asia Summit had a concrete and measurable positive agenda, while the Hiroshima summit was mainly prescriptive and declarative, with limited tangible outcomes. The China-Central Asia Summit was driven by the realisation that Eurasian countries must actively collaborate to counter the perceived destabilising efforts of the United States, the driving force behind the G7, in the shared neighbourhood of Russia and China in Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan). China has agreed to provide RMB 26 billion (US$3.7 billion) in grants to the five Central Asian countries as result of the summit.

Saudi Arabia, known for its abundant oil reserves, has officially applied to join the BRICS alliance. Anil Sooklal, the South African BRICS ambassador, has confirmed that five Middle Eastern countries, namely Saudi Arabia, the United Arab Emirates, Bahrain, Egypt, and Algeria, have expressed their interest in joining the bloc. These nations are major exporters of oil to the Western countries and conduct transactions in US dollars. Discussions are underway regarding Saudi Arabia's potential funding of the BRICS bank, also known as the New Development Bank (NDB). If the BRICS alliance accepts Saudi Arabia's financial support, it could potentially lead to a new era of financial influence, bolstered by continuous cash flow from the oil-rich nation. The funding from Saudi Arabia presents a challenge to the global dominance of the US dollar as the primary reserve currency. In 2023, not only BRICS but also a new coalition of ASEAN countries has emerged with the intention to reduce dependence on the US dollar, as they recently signed a declaration to cease using the USD for international trade and instead promote their native currencies for cross-border transactions.

ARTIFICIAL INTELLIGENCE – ENHANCE NOT REPLACE

The integration of Artificial Intelligence (AI) in the intelligence cycle is expected to continue driving innovation and transforming the way intelligence products are developed and shared. While AI offers the potential to enhance analytic capabilities and increase efficiency, it cannot replace the need for human expertise. Trained intelligence professionals with digital skills will continue to be in high demand.

The integration of AI technologies has gained significant attention in 2023, with tools like ChatGPT and image generators capturing the imagination of users. Companies like Microsoft and Alphabet have also introduced AI-powered applications to improve search engines and chatbots. These technologies have the potential to optimise intelligence collection, processing, analysis, and dissemination. Large language models (LLMs) like ChatGPT can assist in tasks such as web scraping for protest data, literature reviews on emerging issues, and curating intelligence feeds, thereby saving analysts' time.

The integration of AI in the financial industry holds significant implications for how intelligence and insights are generated and utilised in this sector. AI-powered tools and technologies have the potential to revolutionise financial analysis, risk assessment, investment strategies and customer service. AI can also automate repetitive tasks and streamline operational processes in the financial industry. For example, natural language processing algorithms can automate data entry, extraction, and analysis, reducing the time and effort required for manual data processing. This can free up human resources to focus on higher-value tasks, such as complex financial analysis and strategic decision-making.

However, there are risks and limitations associated with AI integration in intelligence work. Conversational AI used for specialised research can introduce inaccuracies and biases, potentially distorting intelligence assessments. Although AI models like ChatGPT produce convincing text, they often lack accuracy, which can propagate misinformation. The lack of transparency in AI applications, including the inability to explain how conclusions are reached, poses a concern. Transparency and clear reasoning are vital in intelligence assessments, and, without proper explanations, client confidence in intelligence providers may decline.

GREEN ECONOMY - ELECTRIFICATION

Norway has been a leader in the adoption of electric vehicles (EVs) for many years. In 2022, EVs accounted for 80% of new car sales in the country. This is due to a number of factors, including government incentives, a strong public charging infrastructure, and a growing awareness of the environmental benefits of EVs.

The shift to EVs has had a number of positive impacts on Norway. For example, greenhouse gas emissions have decreased, air quality has improved, and new jobs have been created in the EV industry. However, there are still some challenges associated with EV adoption in Norway, such as long wait times at charging stations and a lack of charging infrastructure in rural areas.

KINDERGARDEN OR AGED CARE FACILITY?

The world's population is aging. In 2022, there were 771 million people aged 65+ years globally, accounting for almost 10% of the world's population. This segment has been growing at an increasing rate, and it's expected to hit 16% in 2050, and eventually 24% by 2100 (Figure 4).

There are a number of factors contributing to this trend, including declining birth rates, falling mortality rates, and longer life expectancies. In many countries, the fertility rate has fallen below the replacement level of 2.1 children per woman. This means that each generation is smaller than the one before it, which is leading to an aging population.

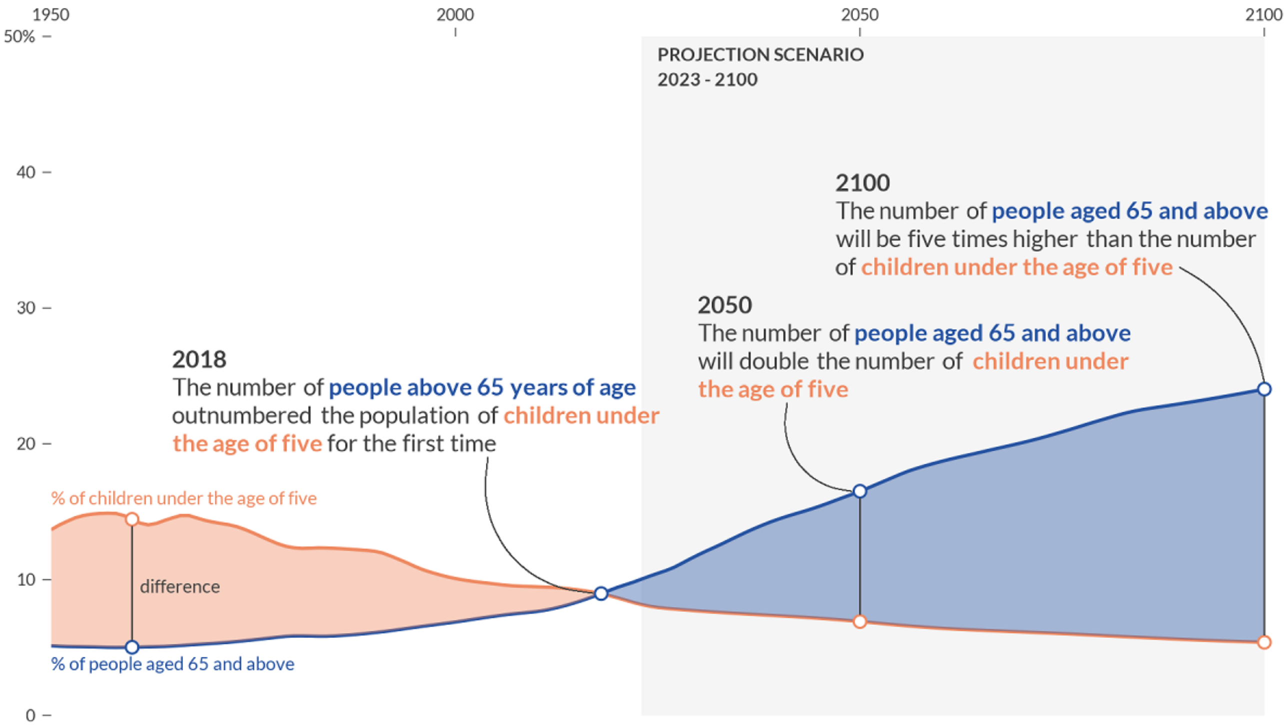
Falling mortality rates are also contributing to the aging population. In the past, many people died young from disease. However, thanks to advances in medicine and healthcare, people are living longer than ever before. This is leading to a larger population of older adults. Finally, longer life expectancies are also contributing to the aging population. People are living longer and healthier lives, which means they are spending more time in the older age groups.

The aging population is having a number of impacts on societies around the world. These include increased healthcare costs, a shrinking workforce, and a decline in economic growth. The change in demographics is affecting infrastructure development and investment. Do we need more kindergartens or aged care facilities now?

Figure 4

The world's population is aging

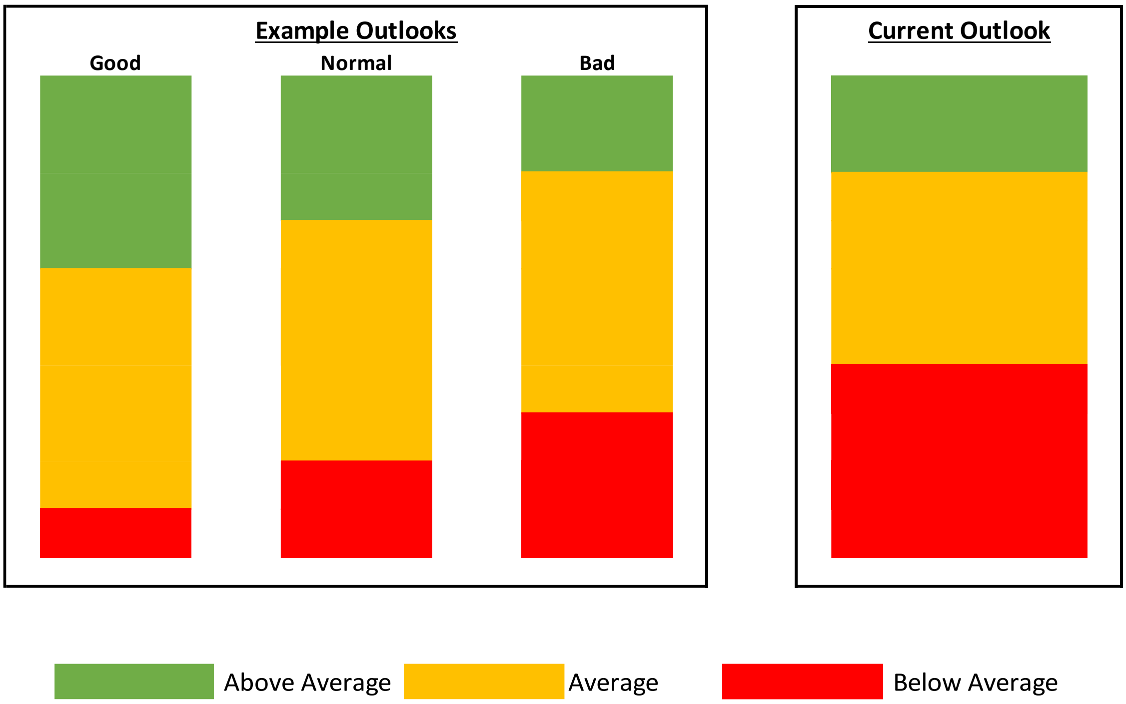
Global population share of children under the age of five versus the global population of people over the age of 65



Visualization: Pablo Alvarez | Source: United Nations World Population Prospects (2022) (via OurWorldInData.org)

MARKET OUTLOOK

For a broadly diversified investor, these are our expectations of their investment outlook over the next 1 to 3 years.



The current market is less likely to have an above average return (green). It is more likely to have an average return (amber) or a below average return (red) over the next two to three years.