

ERIKSENSGLOBAL

Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – JUNE 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	Quarter %	1 Year %
Global Equities				
MSCI World NR	7,179.69	5.7	7.1	18.2
MSCI World NR (NZD)	15,001.65	3.7	9.1	20.3
MSCI Emerging Markets	662.37	3.4	1.7	3.3
S&P 500 (US)	4,450.38	6.5	8.3	17.6
Nikkei 225 (Japan)	33,189.04	7.5	18.4	25.7
FTSE 100 (UK)	7,531.53	1.1	(1.3)	5.1
DAX (Germany)	16,147.90	3.1	3.3	26.3
CAC 40 (France)	7,400.06	4.2	1.1	24.9
Trans-Tasman Equities				
S&P/NZX 50	11,916.47	0.9	0.3	9.6
S&P/ASX 300	87,839.46	1.7	1.0	14.4
Bonds				
S&P/NZX NZ Govt Stock	1,665.94	(1.6)	(1.4)	(0.8)
S&P/NZX A Grade Corporate	5,572.43	(0.4)	0.4	2.0
Barclays Global Agg (Hedged to NZD)	386.13	(0.0)	0.1	(0.3)
Oil and Gold				
West Texas Intermediate Crude	70.64	3.7	(6.6)	(33.2)
Brent Crude	75.68	5.1	(5.0)	(34.2)
Gold	1,919.35	(2.2)	(2.5)	6.2
NZD Foreign Exchange				
AUD	0.9206	(0.6)	(1.5)	1.8
EUR	0.5616	(0.1)	(2.4)	(5.6)
GBP	0.4819	(0.3)	(4.8)	(5.9)
JPY	88.5605	5.8	6.4	4.8
CNY	4.4564	4.3	3.7	6.9
USD	0.6128	2.2	(2.0)	(1.4)

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

Executive summary:

- Equities performed well over the month, driven by tech stocks.
- Bonds are negatively correlated with equities.
- Geopolitical tensions increased, triggered by an unsuccessful military coup in Russia .
- The NZD appreciated against the USD but depreciated against AUD, EUR, and GBP.

ECONOMIC COMMENTARY

*Authored by Janibek Issagulov and reviewed by the Eriksens team.
10 July 2023*

GLOBAL SNAPSHOT

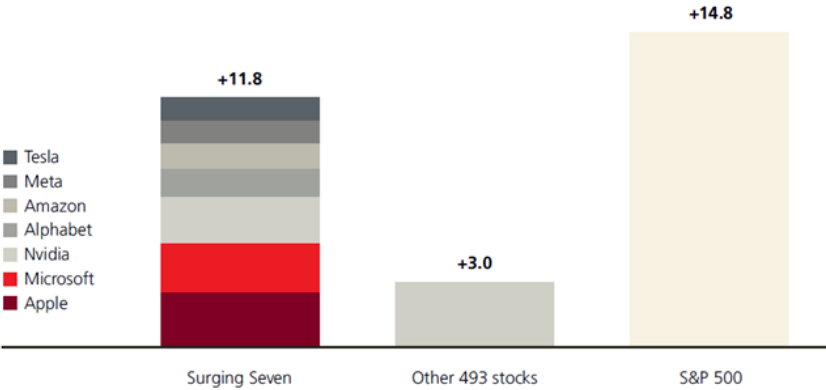
The Federal Reserve pressed pause on its rate hikes at its June meeting, despite the addition of two more 25-basis-point increases, projected for later this year. Some analysts consider this unwise, given inflation remains elevated, with the core consumer price index exceeding the Fed's target at 5.3% year-on-year and increasing by 0.4% month-on-month in May alone. Additionally, the labour market remains tight as job openings continue to rise, despite a slight uptick in the unemployment rate. The level of uncertainty regarding the delayed effects on the economy is high with the Fed having implemented a rapid pace of rate increases, adding 500 basis points in just 14 months. There have already been indications of financial instability, such as increasing corporate bankruptcies and credit card delinquencies. Considering these circumstances, the Fed must prioritise risk management across all its responsibilities, including price stability, full employment and financial stability.

Diverging from the Fed's decision to pause rate hikes, the European Central Bank (ECB) raised interest rates by 25 bps to 3.5%. The ECB has been increasing rates since July 2022 in an effort to curb high inflation levels in the region. However, the latest inflation figures showed a faster-than-expected slowdown. Headline inflation fell by 0.6% from 6.1% to 5.5% in May while core inflation rose by 0.1% to 5.4%. These results are still well above the ECB's target of 2%. While the market anticipated the ECB's decision to raise rates, there remains considerable uncertainty regarding the central bank's future actions beyond the summer (one more hike is expected in July). The ECB stated that its forthcoming decisions would aim to achieve a timely return of inflation to the 2% medium-term target by implementing sufficiently restrictive interest rates, which would be maintained for as long as necessary.

In the first half of 2023, technology stocks have emerged as notable performers. NVIDIA, a prominent provider of chips for various artificial intelligence (AI) applications, has experienced a significant surge, with its market capitalisation surpassing \$1 trillion, and its stock rallying by 194%. Additionally, other technology companies have reaped the rewards of optimistic expectations surrounding increased revenue driven by AI advancements (Figure 1). The NYSE FANG+ Index, which monitors the performance of the top 10 technology stocks in the United States, has recorded a year-to-date increase of 75%.

Figure 1

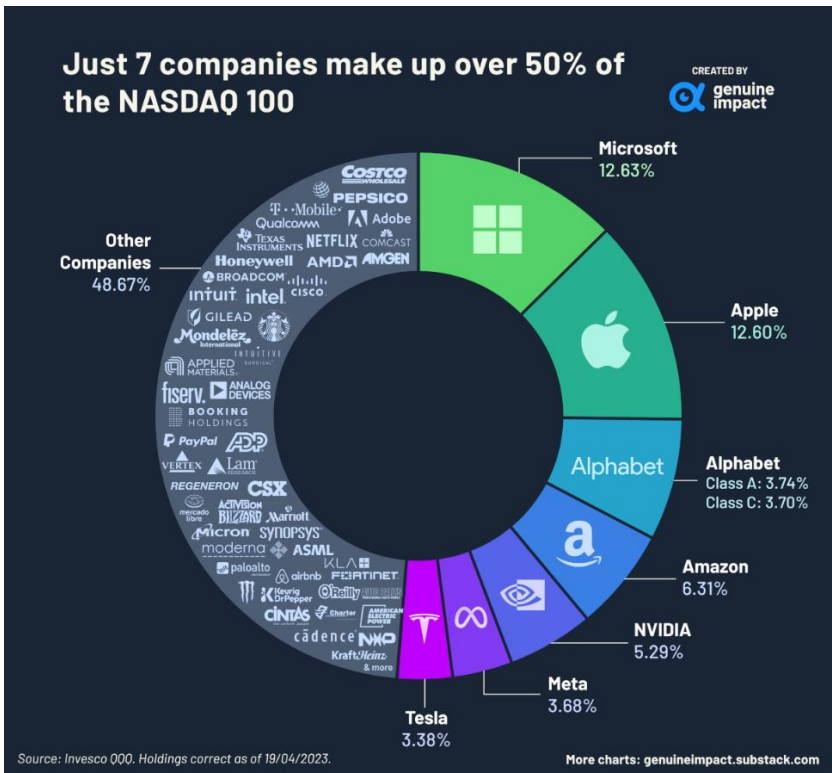
The “surging seven” have been driving performance this year
 S&P 500 year-to-date return, percentage point contribution from the “surging seven” mega-cap stocks and the other 493 stocks of the index, in %



Source: Factset, UBS, as of 14 June 2023

The dominance of these seven firms within the Nasdaq-100 index reflects their crucial role in various sectors of the broader consumer economy (Figure 2). The tech giants' significant economic output and influence are evident, with Tesla continuing to lead the rapidly expanding electric vehicle market. Among them, NVIDIA stands out as the underdog, manufacturing graphics processing units (GPUs) powering visuals in numerous electronic devices and, more recently, AI systems. It's important to acknowledge that this composition of companies changes significantly over time, as seen with the likes of Intel and Cisco, which were prominent components of the Nasdaq-100 in the 2000s but have since seen their allocations decline, while other companies like Yahoo! are no longer publicly traded.

Figure 2



Source: Invesco QQQ. Holdings correct as of 19/04/2023.

More charts: genuineimpact.substack.com

Despite the recent bonds sell-off, bonds are now less risky than equities (Figure 3). Compared to last year, bonds have become more reliable as their yields have increased. Even if yields continue to rise as expected, there is now a comfortable buffer. Any decreases in bond prices should be compensated by the income generated by the bonds. It is unlikely that bonds will see declines of the same magnitude as in 2022.

Figure 3

Bonds offer a better risk-reward than equities

MSCI ACWI equity risk premium (dividend discount model calculation) and yield gap (earnings yield less 10-year Treasury yield), averages, in %



Source: Refinitiv, UBS, as of June 2023

Apple has become the most valuable company in the world, with a market cap of \$3 trillion. This is a number of gargantuan proportions, equivalent to the annual GDP of France or nearly double the size of India's entire stock market. Apple's mammoth size is backed up by its underlying business of selling high-tech products, each with a massive ecosystem built around it. This makes it more and more difficult for its customers to leave for a competitor. Apple is on track to generate \$400 billion in annual revenue and \$100 billion in annual profit for the year to 30 September.

France braced for a week of unrest at the end of June, with 45,000 police deployed to deter rioters who have torched cars, looted stores and targeted town halls and police stations triggered by the death of teenager Nahel Merzouk who was shot by police. President Emmanuel Macron postponed a state visit to Germany to meet with leaders of parliament and more than 220 mayors in order to deal with the crisis. The interior ministry reported 719 arrests following Nahel's funeral, down from 1,311 on the day before. Officials have cautioned it is too early to say the unrest is over. The riots have also spread to French speaking cities of Switzerland and Belgium.

LOCAL SNAPSHOT

The New Zealand economy has entered a technical recession, with data released by Stats NZ showing GDP declined by a seasonally adjusted 0.1% during the quarter ended 31 March. This marks the second consecutive quarter of negative economic growth, following a revised 0.7% decline in the previous quarter. Most sectors of the economy experienced a slowdown or contraction, with services, exports, and agriculture offsetting a slight increase in construction activity.

The labour market, which had been experiencing strong growth, is showing signs of cooling off (which was expected, following a significant tightening of monetary policy over the past year and a half). However, it remains uncertain whether this slowdown is sufficient to align with a return to low and stable inflation. The presence of migrant workers, who have resumed entering the country since New Zealand reopened its borders, may impact perceptions of job availability. While migrants can help address skill shortages, their overall impact on the economy's demand level is mixed. For now, it seems that migrants are viewed as contributing more to the supply side, which helps address distortions that arose during the border closure period. Additionally, there has been a noticeable decrease in demand for workers compared to previous levels.

Prime Minister Chris Hipkins expressed interest in strengthening economic relations with China during a meeting with Chinese President Xi Jinping in Beijing in late-June. Accompanied by a business delegation representing sectors such as tourism and education, Hipkins went on a five-day visit to China, his first since assuming office. As New Zealand enters a recession, officials view China as a crucial partner for post-pandemic economic revival, particularly in the areas of exports, tourism, and education. Despite New Zealand occasionally criticizing China's human rights and foreign policy practices, the country has maintained relatively warm relations with Beijing compared to US and Europe.

A range of subsidies aimed at reducing the cost of living and temporary tax cuts expired on 1 July, leading to concerns among economists and budgeting services that it will have a negative impact on those who are already facing financial difficulties. Among these changes, the termination of the fuel tax discount will have the most significant effect on New Zealanders' finances, resulting in a 25 cent per litre increase and nearly 4 cents in additional GST. Furthermore, the subsidy for road user charges on diesel vehicles will also come to an end.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was up 5.7%, and MSCI Emerging Markets returned 3.4% in June in local currency terms.

The S&P 500 Index closed the June month with a gain of 6.6%. Positive growth and inflation surprises helped the major benchmarks round out a solid quarter on a high note. The rally also broadened, with small-caps and value shares outperforming. The technology-heavy Nasdaq Composite was up 6.7% in June, ending the week with a six-month gain of about 32%, its best start to the year since 1983.

The MSCI Europe ex UK Index added 2.7% in June, on hopes that China would do more to boost consumption and that lower-than-expected inflation data could mean that interest rates are near their peak. The major equity indices posted gains in June: Germany's DAX Index firmed 3.1%, France's CAC 40 Index rallied 4.3% and the UK's FTSE 100 Index rose 1.2%.

Chinese equities had mixed performances over the month, as weak economic indicators offset optimism that the government might implement additional measures to bolster economic growth. The Shanghai Stock Exchange Index advanced 0.8% in June.

Australian large-cap stocks continued their upward trend, building on their gains for both the quarter and the first half of 2023. However, small-cap stocks did not perform as well as their more established counterparts, both in the past month and year-to-date. Equities in New Zealand slightly underperformed compared to Australian stocks. Nonetheless, New Zealand's blue-chip stocks managed to finish both June and the first half of 2023 with positive returns.

Fixed Interest

The positive news for equity investors had a negative impact on the US Treasury market, causing a rise in the yield of the 10-year bond. The yield reached 3.87%, its highest level since March 2023. The 2-year Treasury yield experienced a 50bps increase over the month and increased by 47 bps year-to-date. By 7 July its yield exceeded 4%. A 14 year real yield high!

European government bond yields remained close to their highest levels, as inflation eased slightly but still remained above the ECB's target of 2%. The yield on the 10-year German government bund rose by 11bps but decreased by 18bps year-to-date.

The US investment-grade corporate bond market saw low levels of issuance in advance of their Independence Day holiday. Those bonds that did come to market were met with strong demand.

Bonds sold off in June in both Australia and New Zealand, but are still holding their year-to-date gains.

GEOPOLITICS

An attempted military coup in Russia, led by the chief of Wagner Group (a state-funded paramilitary organisation), was a shocking turn of events. Coup-leader Prigozhin was a member of the inner circle of Russian elite close to Putin and known as "Putin's chef" because his catering company serviced governmental ceremonies and supplied food to state-owned entities, including Ministry of Defence units. Wagner participates in conflicts around the world, including the civil wars in Syria, Libya, the Central African Republic and Mali. The coup started after a Wagner camp was allegedly bombed by the Russian defence ministry. Tensions between Prigozhin and Minister of Defence Sergey Shoigu, supported by Deputy Minister of Defence Valery Gerasimov, started after the former accused Shoigu and Gerasimov of sabotaging the offense in Ukraine. Prigozhin has blamed both officials of failing to supply adequate ammunition, clothing and other basics, causing thousands of casualties to Russian troops.

Earlier in the year, Prigozhin visited the biggest cities in Russia to officially promote Wagner's contract services. However, a lack of an official agenda and the names of those he met with remaining a mystery points to a possible crack within the Russian political establishment. There are a number of people within top circles unhappy with the war and were looking for someone who could do the heavy lifting in the fight

for power with Putin. Unfortunately, Prigozhin's retreat and relocation to Belarus towards the end of June threw all his supporters 'under the bus' of Putin's repression machine. There are still many unknowns surrounding the coup and many believe that "it ain't over yet".

US Secretary of State Antony Blinken met with Chinese President Xi Jinping mid-June for a surprise 35-minute meeting. Blinken also met with China's top diplomat Wang Yi and Foreign Minister Qin Gang. The two sides agreed to maintain high-level interactions and schedule reciprocal visits. However, geopolitical tensions could still remain high as neither country has changed their threat assessments. Blinken emphasized that the US will always stand up for Americans' values and addressed China's unfair economic practices. Currently the US is blocking China's access to advanced chip tech and pushing its allies in Europe and Asia to do the same.

Iran was formally approved as a member of the Shanghai Cooperation Organization (SCO) at its virtual summit on 4 July. Iran has been seeking to reduce its isolation and improve its economy, and SCO membership is seen as a step in that direction. The SCO is a diplomatic organisation with eight members, including India and Pakistan. Belarus has also now started the application process.

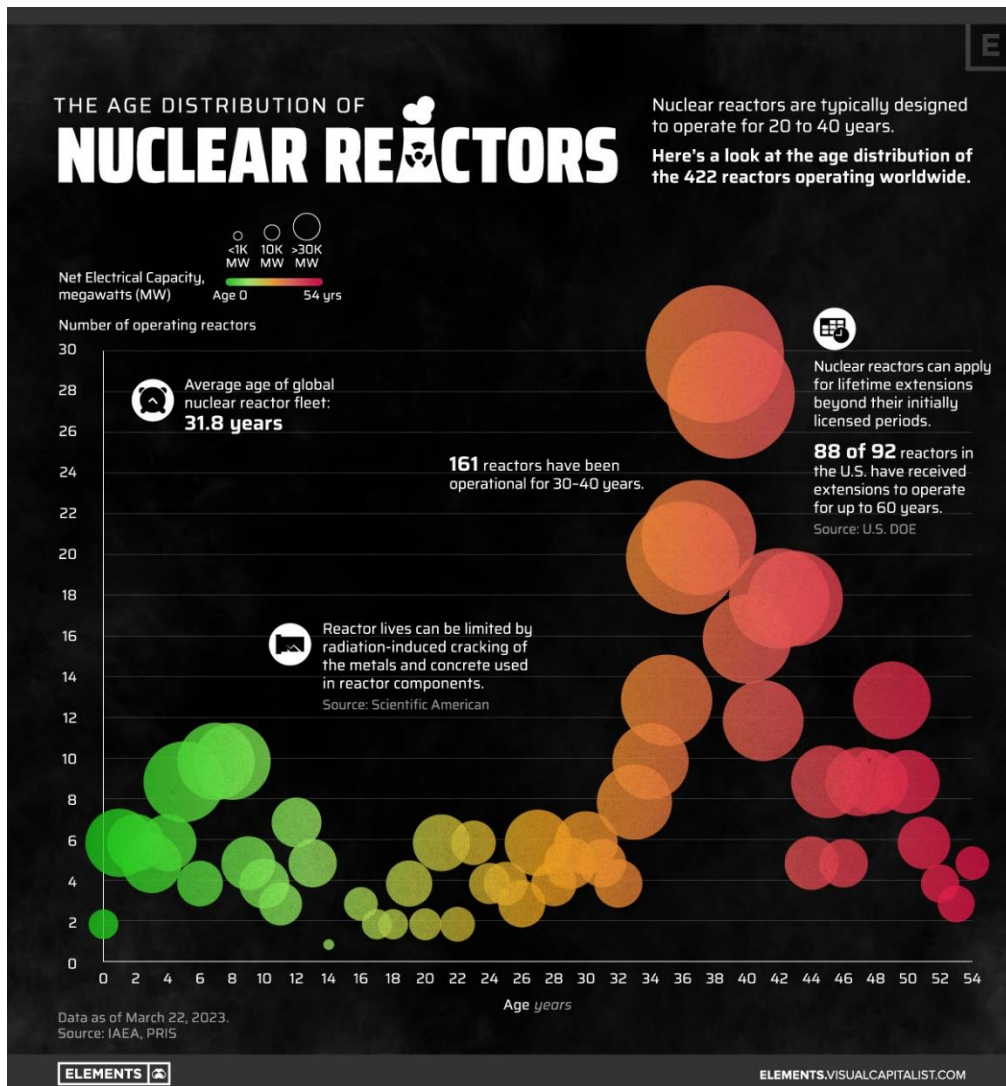
NUCLEAR POWER – IS THERE LIFE AFTER END?

Sweden has changed its electricity mix target from "100% renewable" to "100% fossil-free," paving the way for new nuclear reactors to be built. This is a significant shift, as Sweden had previously decided to phase out nuclear power 40 years ago. However, the country now sees nuclear power as necessary for meeting its target of reaching net zero emissions by 2045. Sweden's state-owned power and heat utility Vattenfall is considering building at least two small modular reactors (SMRs) and extending the life of existing reactors. Currently, around 98% of electricity in Sweden is generated from hydropower, nuclear energy, and wind.

Sweden is not the only country in Europe that is reconsidering its stance on nuclear power. Romania and Bulgaria are also planning new nuclear capacity, while Germany has refused to reconsider the shutdown of its last reactors. This suggests that there is a growing consensus in Europe that nuclear power will play a role in the continent's transition to a clean energy future, although Austria and Luxembourg fiercely oppose nuclear power.

The majority of the world's nuclear reactors (62%) were built between 1973 and 1992 (Figure 4). As a result, many of these reactors are now approaching, or have exceeded, their originally licensed lifespans. However, it is possible for reactors to operate beyond their initial lifespans with lifetime extensions. This requires rigorous assessments, safety evaluations, and refurbishments. Some countries, such as the United States, have granted license renewals for aging reactors, with some reactors even being approved to operate for up to 80 years.

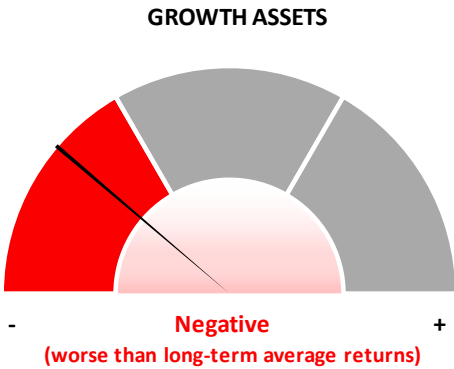
Figure 4



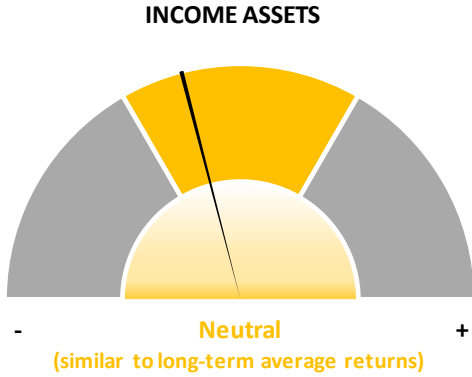
The logical question is what to do after reactors reach their end of lifespan? The decommissioning of a nuclear power plant is the final step in its lifecycle. It involves activities from the shutdown and removal of nuclear material to the environmental restoration of the site. The whole process is complex and typically takes 20 to 30 years to complete. According to the US Nuclear Regulatory Commission, decommission costs range from \$300 million to \$400 million. The UK's Nuclear Decommissioning Authority estimates it will cost current and future generations of UK taxpayers £132 billion to decommission the UK's civil nuclear sites, and the work will not be completed for another 120 years.

MARKET OUTLOOK

Our investment outlook expectations over the next 12-18 months are:



- Growth Assets Include:**
- Global equities
 - Australasian equities
 - Property



- Income Assets Include:**
- Global bonds
 - Australasian bonds
 - Other debt instruments