ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – AUGUST 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	Quarter %	1 Year %
Global Equities				
MSCI World NR	7,259.29	(1.8)	6.9	14.7
MSCI World NR (NZD)	15,572.43	2.0	7.7	19.0
MSCI Emerging Markets	664.86	(4.7)	3.8	2.3
S&P 500 (US)	4,507.66	(1.8)	7.8	14.0
Nikkei 225 (Japan)	32,619.34	(1.7)	5.6	16.1
FTSE 100 (UK)	7,439.13	(3.4)	(0.1)	2.1
DAX (Germany)	15,947.08	(3.0)	1.8	24.2
CAC 40 (France)	7,316.70	(2.4)	3.1	19.5
Trans-Tasman Equities				
S&P/NZX 50	11,554.48	(4.2)	(2.2)	(0.4)
S&P/ASX 300	89,691.64	(0.8)	3.9	9.0
Bonds				
S&P/NZX NZ Govt Stock	1,652.90	(0.6)	(2.4)	(1.3)
S&P/NZX A Grade Corporate	5,597.80	0.2	0.1	2.2
Barclays Global Agg (Hedged to NZD)	385.71	(0.2)	(0.1)	(0.2)
Oil and Gold				
West Texas Intermediate Crude	83.63	2.2	22.8	(6.6)
Brent Crude	87.41	2.7	21.4	(8.7)
Gold	1,940.19	(1.3)	(1.1)	13.4
NZD Foreign Exchange				
AUD	0.9192	(0.5)	(0.7)	2.8
EUR	0.5485	(2.8)	(2.4)	(10.0)
GBP	0.4698	(2.9)	(2.9)	(10.8)
JPY	86.6754	(2.0)	3.5	2.0
CNY	4.3319	(2.5)	1.4	2.5
USD	0.5952	(4.4)	(0.7)	(2.9)

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

Executive summary:

- Both bonds and equities sold off in August on new inflation data and a weak Chinese economy.
- Geopolitical rivalry between West and East is escalating.
- Oil prices are around $90 per barrel because of production cuts by Saudis and Russians.
- The NZD depreciated against all major currencies.

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ECONOMIC COMMENTARY

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12 September 2023

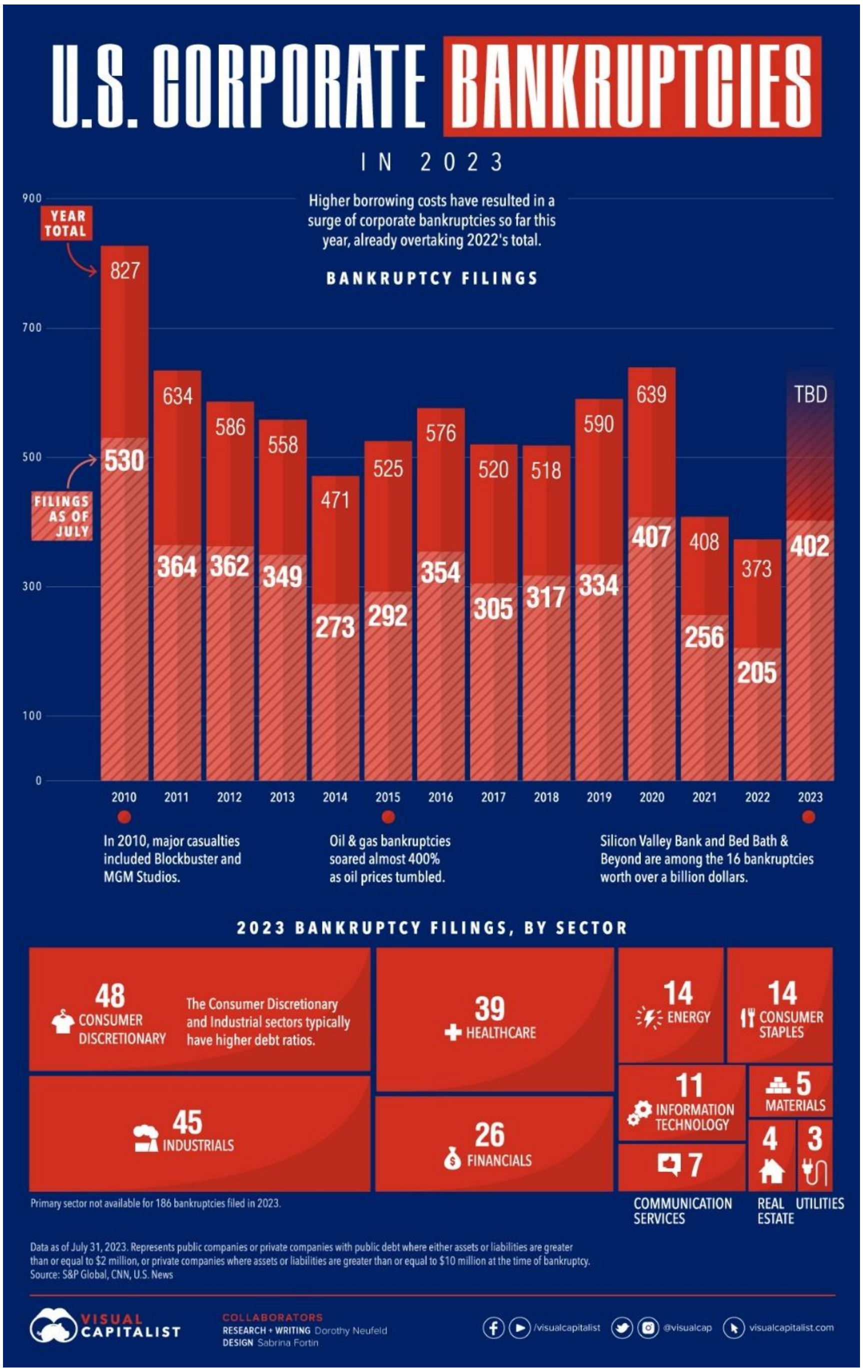
GLOBAL SNAPSHOT

Analysts believe the Fed's interest rate hikes may be coming to a halt. This sentiment arose following a government report that revealed a rise in the unemployment rate and a slowdown in wage growth. Futures contracts linked to the Federal Reserve's policy rate had already implied a slim likelihood of a rate increase this month. However, they now suggest that the chance of the central bank implementing further tightening this year has decreased to around 38%, down from 45% prior to the release of the latest jobs report. The Labor Department's report disclosed that the unemployment rate climbed from 3.5% to 3.8% last month, while average hourly earnings grew by 4.3% compared to the previous year, a slight dip from July's 4.4% growth. Although employers added 187,000 workers to their payrolls in August, revisions mean job growth in preceding months was actually less robust than reported.

Economists and other market experts are expecting this data to cause the Fed to pause its rate hikes in September. If subsequent inflation data in September and October also proves positive, we anticipate the Fed will conclude its series of rate increases for now. The Federal Reserve has been increasing short-term borrowing costs aggressively since March 2022 to combat the 40-year-high inflation statistics. The most recent hike in July, raised the benchmark rate's target range to 5.25% to 5.50%. Despite inflation moderating from its peak of 7% the previous summer to just 3.3% last month, as per the Fed's preferred inflation gauge, policymakers continue to view it as too high. They are closely monitoring the labor market for signs of softening, aiming to maintain downward pressure on prices, with a target of 2% inflation.

In March, Silicon Valley Bank faced a severe setback, leading its parent company, SVB Financial Group, to file for bankruptcy just a week later. Although there were concerns of a potential wave of bank failures at the time, this scenario has largely been avoided. However, signs of strain are now surfacing, as evidenced by Moody's downgrade of 10 smaller banks in August. In the broader corporate realm, bankruptcy cases are on the rise as well. Companies in various sectors are grappling with stretched financial positions, exacerbated by 11 interest rate hikes implemented since the previous year.In 2023 thus far, more than 400 companies have experienced financial collapse (Figure 1). Corporate bankruptcies are increasing at the most rapid rate since 2010, excluding the pandemic-related period, and have reached a level twice as high as the same period last year. The student loan debt moratorium ends on 30th September in the US. This will impact many household budgets and reduce consumption.

Figure 1



Source: www.visualcapitalist.com

Eurostat reported that the annual inflation rate in the Eurozone remained stable at 5.3% in August, in its preliminary estimate. This figure slightly exceeded the 5.1% anticipated by economists surveyed by FactSet. Meanwhile, the core inflation rate, which gauges underlying price pressures by excluding volatile food and energy costs, decelerated as expected to 5.3%, a 20 bps improvement from July. The ECB's July meeting minutes highlighted the robust labor market in the Eurozone and suggested the possibility of a gentle economic slowdown in line with expectations. The seasonally adjusted unemployment rate remained at an all-time low of 6.4% in July, aligning with consensus forecasts.

LOCAL SNAPSHOT

The RBNZ decided to maintain the level of interest rates for its second consecutive meeting as expected by economists. However, the central bank has indicated a potential need to raise rates in the future to combat inflation. Notably, the RBNZ’s updated projections reveal a marginally elevated trajectory for the OCR, suggesting the possibility of an increase, while the previously anticipated rate cuts have been postponed from next year to 2025.

In the June 2023 quarter, New Zealand's terms of trade experienced an unexpected 0.4% increase, significantly surpassing ASB's projected 3% decline. This surprising upturn appears to be driven by the unexpected resilience of export prices, which only saw a modest 0.6% decrease during the quarter, compared to the anticipated 3.5% drop. Importantly, this boost in export revenue and a reduction in the trade deficit for the quarter was achieved through a substantial 6.8% increase in export volumes, mainly attributed to a rise in primary production. Meanwhile, import prices declined by 1%, largely influenced by a 6.6% decrease in petroleum import prices, that preceded recent fuel price increases. Import volumes also saw a decline of approximately 2.8%, although the headline figure is skewed by a significant 24.1% reduction in petroleum import volumes following a higher baseline in the previous quarter. It is worth noting the deceleration of the domestic economy may be impacting import demand, as several key categories witnessed either stagnant or reduced volumes in both consumer and capital goods sectors for the quarter. These included food and beverages (-0.5%), plastics (-8.7%), iron and steel (-11.1%), electrical machinery (-3.3%), and transport equipment (-1.2%), with the exception being mechanical machinery, where volumes surged by 8.3% to reach a new record high.

This election is set to be distinctly different from previous ones, with Labour and National engaged in a fierce battle for control of the government, sparing no effort to promote their respective proposals while casting doubt on their opponent's plans. People are weary of politicians and their pledges, fueled by years of the ongoing pandemic and persistent divisions within the community, and voters are primarily preoccupied with financial concerns. The pervasive cost of living crisis has intruded into many households, and now the two major parties face the daunting task of convincing the electorate that they have the solution. As the campaigns kick off, Labour's GST policy, initially well-received, faces scrutiny and skepticism, particularly regarding the assurance that retailers, especially supermarkets, will pass on the full savings. Another contentious issue is free dental care, initially dismissed as unaffordable and unattainable by the Greens, and although Labour's own policy targets those under 30 and includes plans to expand the dental workforce, questions about scalability persist. Meanwhile, National has launched a $14 billion tax relief plan, accompanied by explanations of how a National government would finance it.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was down 1.8%, and MSCI Emerging Markets returned -4.7% in July in local currency terms.

The S&P 500 Index finished August with a 1.8% loss, marking its first negative month since February, although hopeful signs regarding inflation boosted major benchmarks and resulted in solid gains in the first days of September. A drop in long-term interest rates benefited growth shares by decreasing the implied future earnings discount, with smaller-cap stocks outperforming and narrowing the year-to-date gap compared to large-caps. In contrast, the technology-centric Nasdaq Composite reported a -2.2% return for August. While trading volumes increased towards the end of the month, overall market activity remained subdued as the summer vacation season drew to a close.

The MSCI Europe ex UK Index returned -2.4% in August. It rose at the end of the month on hopes that interest rates would soon peak and that a recession, while possible, would likely prove to be shallow and short-lived. Stocks also appeared to receive a lift from China's efforts to bolster its economy. Major continental stock indexes saw a boost at the end of the month but still suffered negative returns over the month period. Germany's DAX Index returned -3.0% in August, France's CAC 40 Index was down 2.4% in August, the UK's FTSE 100 Index returned -3.4% over the month.

Chinese stocks rose after the government issued a series of stimulus measures aimed at reviving the economy. The Shanghai Stock Exchange Index lost 5.2% in August.

Australian large caps slipped in August, down 0.7% for the month. Midcaps and small-caps lagged blue chips. The S&P/NZX 50 significantly trailed its counterpart in Australia, giving up 4.2% for the month.

Fixed Interest

Although short-term Treasury yields saw a significant decline during the final week of the month, the yield on the 10-year US Treasury note rose by 15 bps in August.The yield of the two-year US Treasury note decreased by 1 bps over the same period.

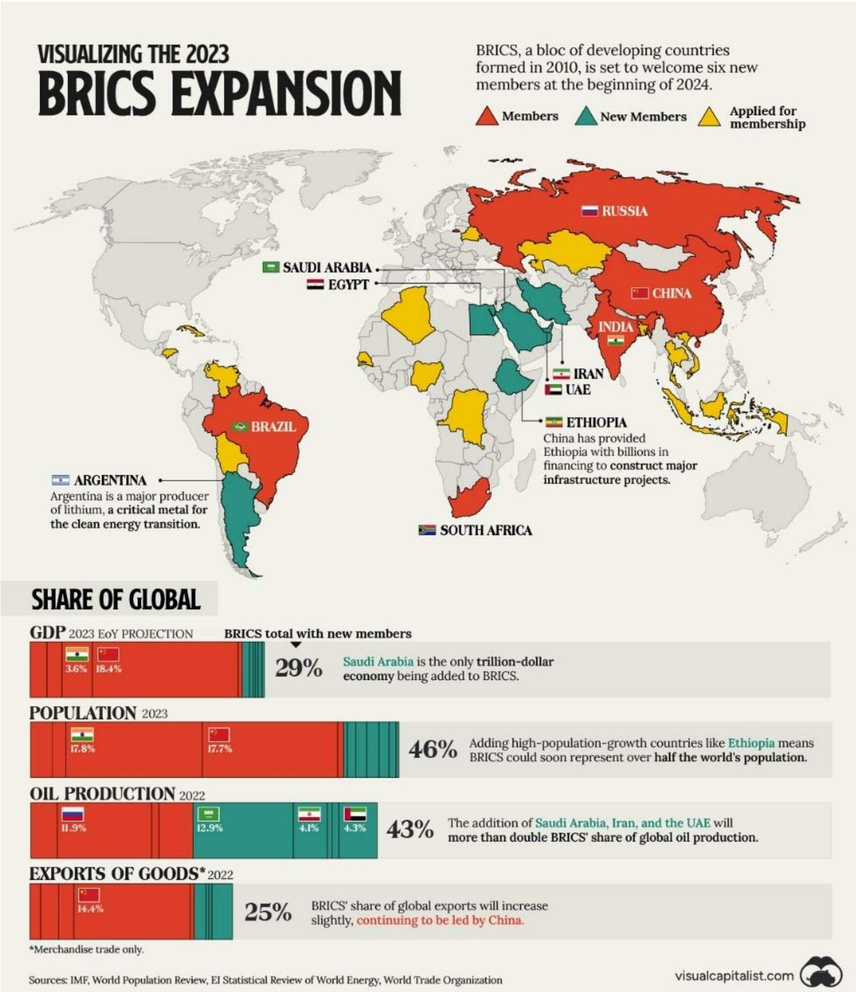
European government bond yields inched downwards as a result of core inflation figures and statements from policymakers hinting at the ECB approaching the conclusion of its monetary policy tightening phase. In August, the yield on the key 10-year German government bund dropped by 3 bps. Similarly, the yields on France's 10-year government bonds also experienced a slight decrease.

Fixed income indices in Australia continued their positive momentum from the second quarter, whereas in New Zealand, there was varied performance. Specifically, the S&P/NZX Inflation-Linked Government Bond Index experienced a 0.8% decline, whereas local authority bonds, bank bills, and short end swaps recorded slight increases.

GEOPOLITICS

The fifteenth BRICS summit will be notable for two reasons: the decision to evolve from BRICS to BRICS+ and the prominence of grievances voiced against the Western world for its role in causing crises and conflicts, along with its apparent inability to manage the aftermath of these situations. In 2024, the BRICS+ coalition will encompass almost half of the global population, with a combined population of 3.9 billion people. This alliance, which has expanded to include energy giants like Iran, Saudi Arabia, and the UAE, also boasts six of the world's top 10 oil producers among its member countries (Figure 2).

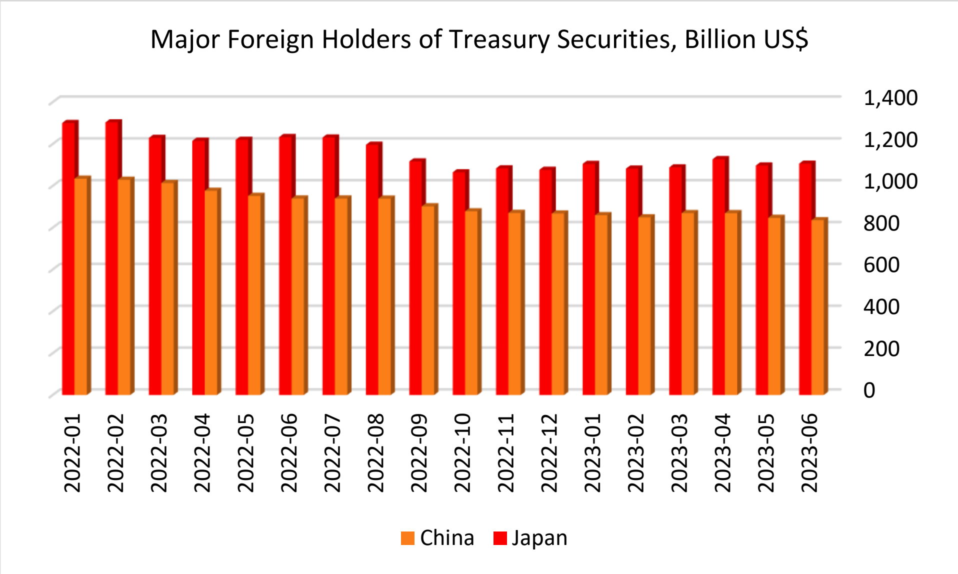
Figure 2



Source: www.visualcapitalist.com

Additionally, it will exert control over 38% of the world's natural gas supply, 60% of oil exports, and 67% of coal production. Furthermore, these 11 nations command approximately one-third of the world's food supply, dominate 90% of the supply chain for solar panels and electric car batteries, and possess essential minerals crucial for the technology industry. As the six new members prepare to officially join BRICS+, there is growing anticipation surrounding the potential introduction of a common currency that could challenge the dominance of the US dollar in the global financial system. The position of US dollar is also being undermined by decrease of Treasury notes holdings by two of its biggest holders, Japan (-15%) and China (-19%) over the last 18 months to June 2023 (Figure 3).

Figure 3



Source: Department of the US Treasury

The presence of around 35 African nations at the Johannesburg summit, invited by South Africa, was followed by another significant gathering of 50 African nations at the third China-Africa Peace and Security forum in Beijing on August 29, after the Russia-Africa Economic and Humanitarian Forum in July. This clearly demonstrates the appeal of President Xi Jinping's 'Global Development Initiative' (GDI) and 'Global Security Initiative' (GSI) within the Global South.

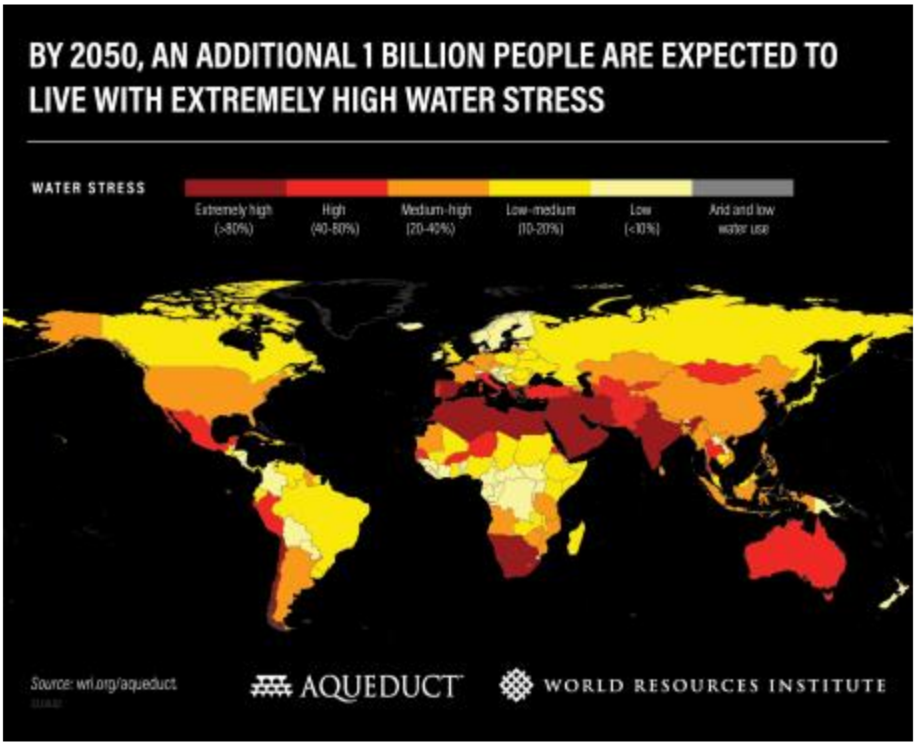
Gabon followed Niger in experiencing a military coup in August, resulting in the removal of the president, whose family had held power for more than fifty years. This occurred shortly after he was declared the winner in a contested election. Ali Bongo Ondimba, also known as Ali Bongo, who had governed the nation, which is rich in oil but grappling with poverty, for almost 14 years, had faced allegations of election fraud and corruption. The coup led to scenes of celebration and public support for the soldiers on the streets of the capital city. However, significant uncertainties persist, including reports of Bongo being placed under house arrest, his son's arrest, the closure of all borders, and a perceived shutdown of the government. International leaders have expressed concerns and disapproval of the coup, with some advising their citizens in Gabon to remain indoors.

Yevgeny Prigozhin, the leader of a Russian mercenary group (actively involved in military actions in Africa), was among the passengers aboard a jet that crashed in Russia, resulting in the tragic deaths of all 10 individuals on board, as confirmed by Russia's civil aviation authority. The aircraft, identified as an Embraer-135 (EBM-135BJ), was en route from Moscow to St. Petersburg on 23 August, carrying seven passengers and three crew members, according to Rosaviatsia, Russia's aviation authority. The passenger list also included Dmitry Utkin, a founder of the Wagner private military company. The plane reportedly crashed approximately halfway between Moscow and St. Petersburg, with all 10 bodies having been recovered, as reported by Russia's state-run news agency Interfax. Analysts exptect that all military activity of the Wagner group in Africa will be transferred to the command of the Ministry of Defence.

FOOD AND WATER VS OIL AND LITHIUM

Recent findings from WRI's Aqueduct Water Risk Atlas reveal that 25 nations, accommodating a quarter of the global population, regularly confront severe water stress, depleting nearly their entire available water resources each year. Furthermore, at least 50% of the world's population, approximately 4 billion individuals, experience significant water stress conditions for a minimum of one month annually. This heightened level of water stress poses a substantial threat to people's lives, employment opportunities, as well as food and energy security. Water plays a pivotal role in agricultural production, energy generation, public health, societal equity, and the achievement of global climate objectives. If improved water management measures are not implemented, the challenges presented by population growth, economic advancement, and climate change are likely to exacerbate water stress (Figure 4).

Figure 4

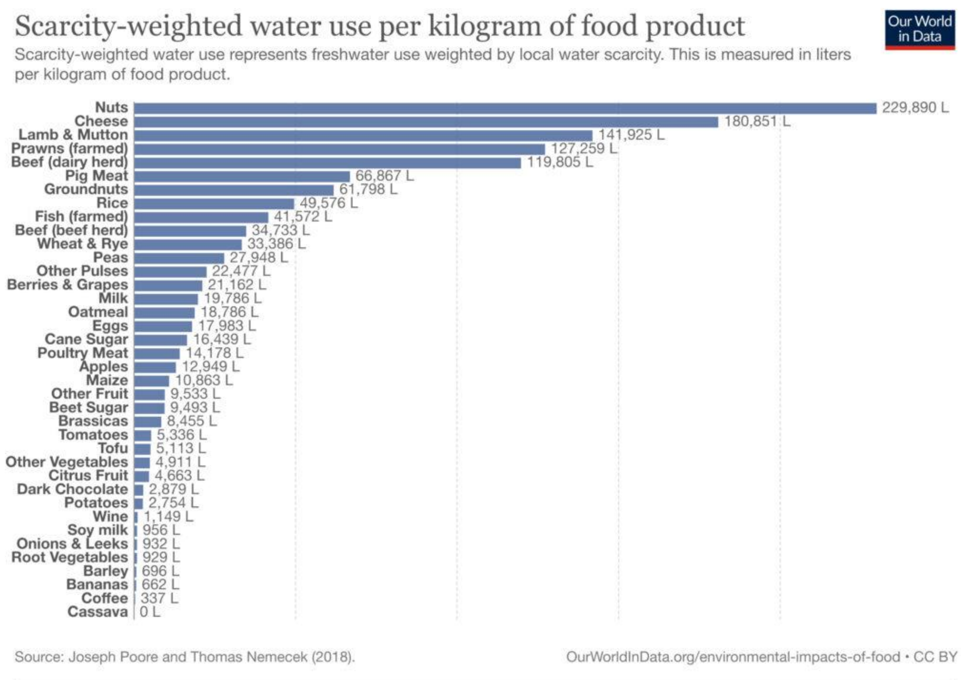


Source: www.wri.org

The latest data reveals that 25 nations are currently grappling with severe annual water stress, wherein they utilize over 80% of their renewable water resources for various purposes, including irrigation, livestock, industry, and domestic consumption. This precarious situation puts these regions at risk of water scarcity, often leading governments to implement water restrictions. This predicament has been observed in several parts of the world, including England, India, Iran, Mexico, and South Africa. Notably, the five countries facing the most acute water stress are Bahrain, Cyprus, Kuwait, Lebanon, Oman, and Qatar. Their water stress primarily stems from a combination of limited water supply and high demand for domestic, agricultural, and industrial purposes. Geographically, the Middle East and North Africa stand out as the most water-stressed regions, with 83% of the population exposed to extreme water stress, followed by South Asia, where 74% of the population faces similar conditions.

Vietnam-based firms refrained from purchasing rice from local farmers last month, a departure from its typical procurement of thousands of tonnes per year. This change was prompted by a surge in rice prices in Asia due to India's ban on non-basmati rice exports and concerns over diminished output in Thailand, the second-largest rice exporter. Rice prices in the region have reached levels not seen in nearly 15 years, with Thai white rice, 5 percent broken, a regional benchmark, reaching approximately $650 per tonne, a price point reminiscent of the global financial crisis in October 2008, according to data from the Thai Rice Exporters Association. Meanwhile, traders in Vietnam anticipate that high-quality rice could soon command prices as high as $700 per tonne, driven by the per-tonne price of the standard 5 percent broken rice, which recently ranged from $550 to $575, as per official customs data. This price surge is expected to continue, driven by factors such as import-dependent countries like the Philippines and Indonesia seeking to secure their rice supplies, with Indonesia's upcoming election in February adding to the urgency of its efforts. Additionally, the closure of short seller positions by purchasing shares has contributed to the upward momentum in rice prices. In 2023, Asia's rice output has faced challenges due to heatwaves associated with El Nino conditions (1 kilo of rice requires almost 50 tonnes of water – Figure 5), disrupting harvests and supply chains. India, responsible for 40 percent of global rice exports, saw around 30 percent of its rice shipments, equivalent to 12 percent of total global trade, affected by last month's export ban, with exceptions made by Delhi to address food security concerns in other nations.

Figure 5



In addition to the catastrophic situation with water and food supply investors are worried more about oil and transtioning to a green economy (electrification). Oil prices surged by over 1.3%, reaching their highest point in a span of 10 months. Brent crude, the international benchmark, crossed the $90 per barrel mark, a threshold it hadn't breached since November 2022. Concurrently, West Texas Intermediate crude oil traded at approximately $87 per barrel, also marking a 10-month high. This surge in prices followed a statement released by the state-run Saudi Press Agency, announcing that Saudi Arabia and Russia (*both are BRICS+ members*) intended to extend their oil production cuts for an additional three months, extending until December. This decision, which was more aggressive than what traders had anticipated from the two largest

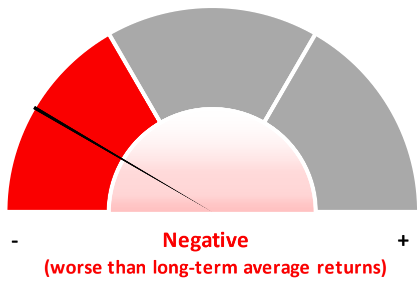
OPEC+ producers, will maintain output at around 9 million barrels per day for six months, marking one of the lowest levels in recent years.

A potential lithium shortage looms on the horizon as demand for the metal escalates, and some analysts believe this shortage could materialize as early as 2025, although others anticipate a longer timeline. Among those predicting a deficit in lithium supply by 2025 is BMI, a research unit of Fitch Solutions. In a recently released report, BMI primarily attributed this anticipated deficit to China, where the demand for lithium is expected to surpass domestic supply. The report stated an expected annual growth rate of 20.4% year-on-year for China's lithium demand solely for electric vehicles (EVs) from 2023 to 2032. In contrast, BMI projected that China's lithium supply would only grow by 6% over the same period, which would not be sufficient to meet even one-third of the projected demand. China currently ranks as the world's third-largest lithium producer, a critical component in electric vehicle batteries. In 2021, the global lithium production stood at 540,000 metric tons, and by 2030, the World Economic Forum estimates that global demand will surge to over 3 million metric tons.

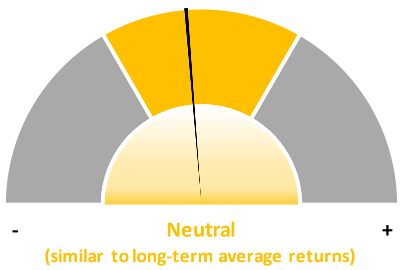
MARKET OUTLOOK

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

GROWTH ASSETS



INCOME ASSETS



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

Income Assets Include:
- Global and Australasian bonds
- Cash and term deposits
- Other debt instruments