MARKET PERFORMANCE AND COMMENTARY – SEPTEMBER 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	Quarter %	1 Year %
Global Equities				
MSCI World NR	6,991.06	(3.7)	(2.6)	20.4
MSCI World NR (NZD)	14,766.78	(5.2)	(1.6)	14.8
MSCI Emerging Markets	652.93	(1.8)	(1.4)	10.9
S&P 500 (US)	4,288.05	(4.9)	(3.6)	19.6
Nikkei 225 (Japan)	31,857.62	(2.3)	(4.0)	22.8
FTSE 100 (UK)	7,608.08	2.3	1.0	10.4
DAX (Germany)	15,386.58	(3.5)	(4.7)	27.0
CAC 40 (France)	7,135.06	(2.5)	(3.6)	23.8
Trans-Tasman Equities				
S&P/NZX 50	11,296.43	(2.2)	(5.2)	2.1
S&P/ASX 300	87,100.78	(2.9)	(0.8)	12.9
Bonds				
S&P/NZX NZ Govt Stock	1,619.52	(2.0)	(2.8)	(1.7)
S&P/NZX A Grade Corporate	5,543.31	(1.0)	(0.5)	2.5
Barclays Global Agg (Hedged to NZD)	379.11	(1.7)	(1.8)	1.7
Oil and Gold				
West Texas Intermediate Crude	90.79	8.6	28.5	14.2
Brent Crude	96.30	10.2	27.2	11.8
Gold	1,848.63	(4.7)	(3.7)	11.3
NZD Foreign Exchange				
AUD	0.9311	1.3	1.1	5.8
EUR	0.5677	3.5	1.1	(1.7)
GBP	0.4924	4.8	2.2	(2.8)
JPY	89.6673	3.5	1.2	9.5
CNY	4.3801	1.1	(1.7)	8.6
USD	0.6010	1.0	(1.9)	6.2

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

Executive summary:

- Both bonds and equities continued their downward trajectory.
- Proxy wars continue between the West and East.
- Oil prices increased, ending the month at around $90 per barrel.
- The NZD appreciated against all major currencies.

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ECONOMIC COMMENTARY

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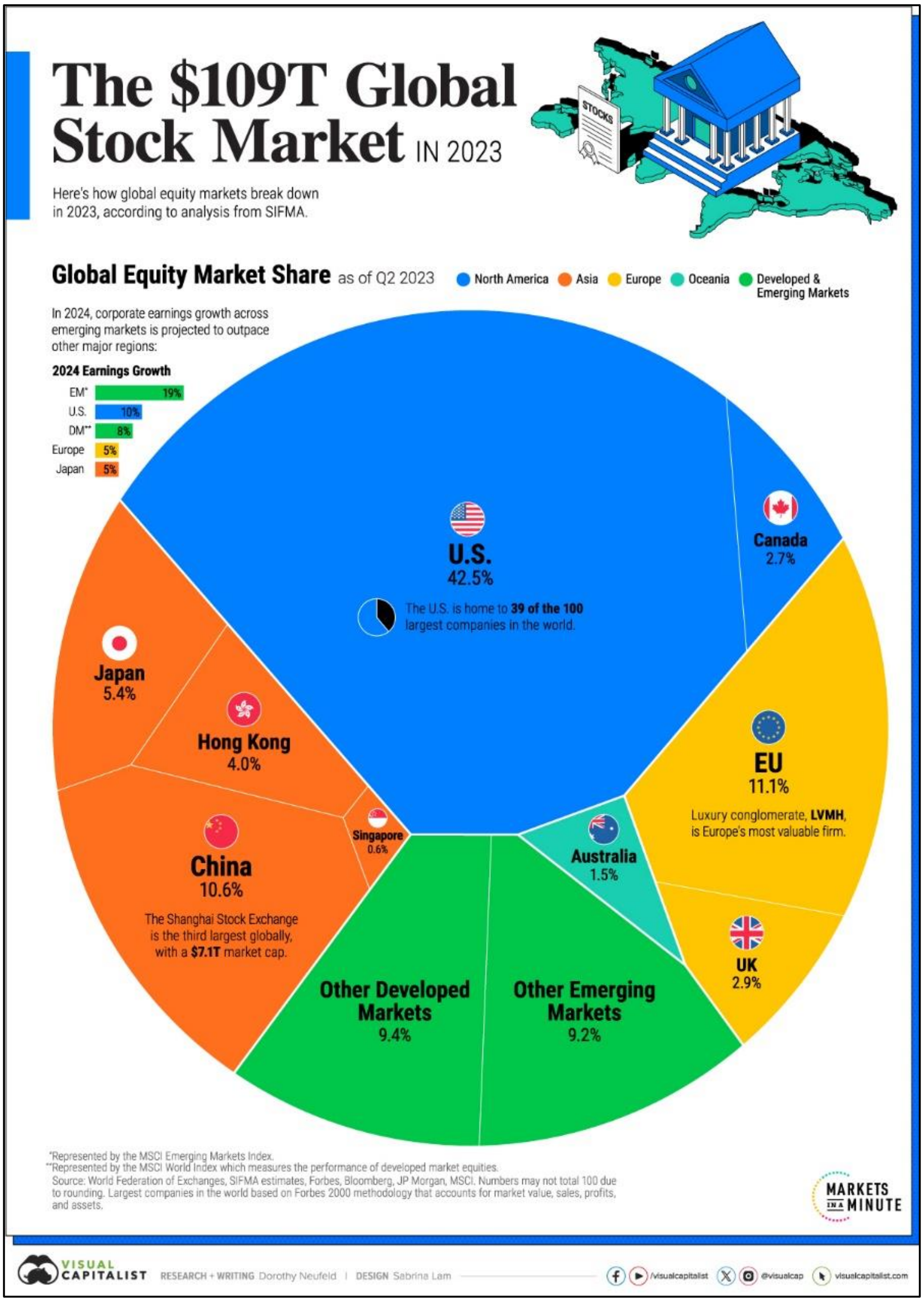
6 October 2023

GLOBAL SNAPSHOT

On the last Friday of September, the S&P 500 closed down as investors analysed the implications of a US inflation report for the Federal Reserve's interest rate strategy and made adjustments to their portfolios on a lacklustre third quarter for stocks. This quarter saw the S&P 500 and Nasdaq experience their most significant monthly percentage declines of the year, while all three major indices recorded their first quarterly declines in 2023. The data indicated that the personal consumption expenditures (PCE) price index, which excludes the volatile food and energy components, rose by 3.9% on an annual basis for August, marking the first time in over two years that it had fallen below the 4% threshold. The Federal Reserve monitors the PCE price indexes as part of its efforts to achieve a 2% inflation target.

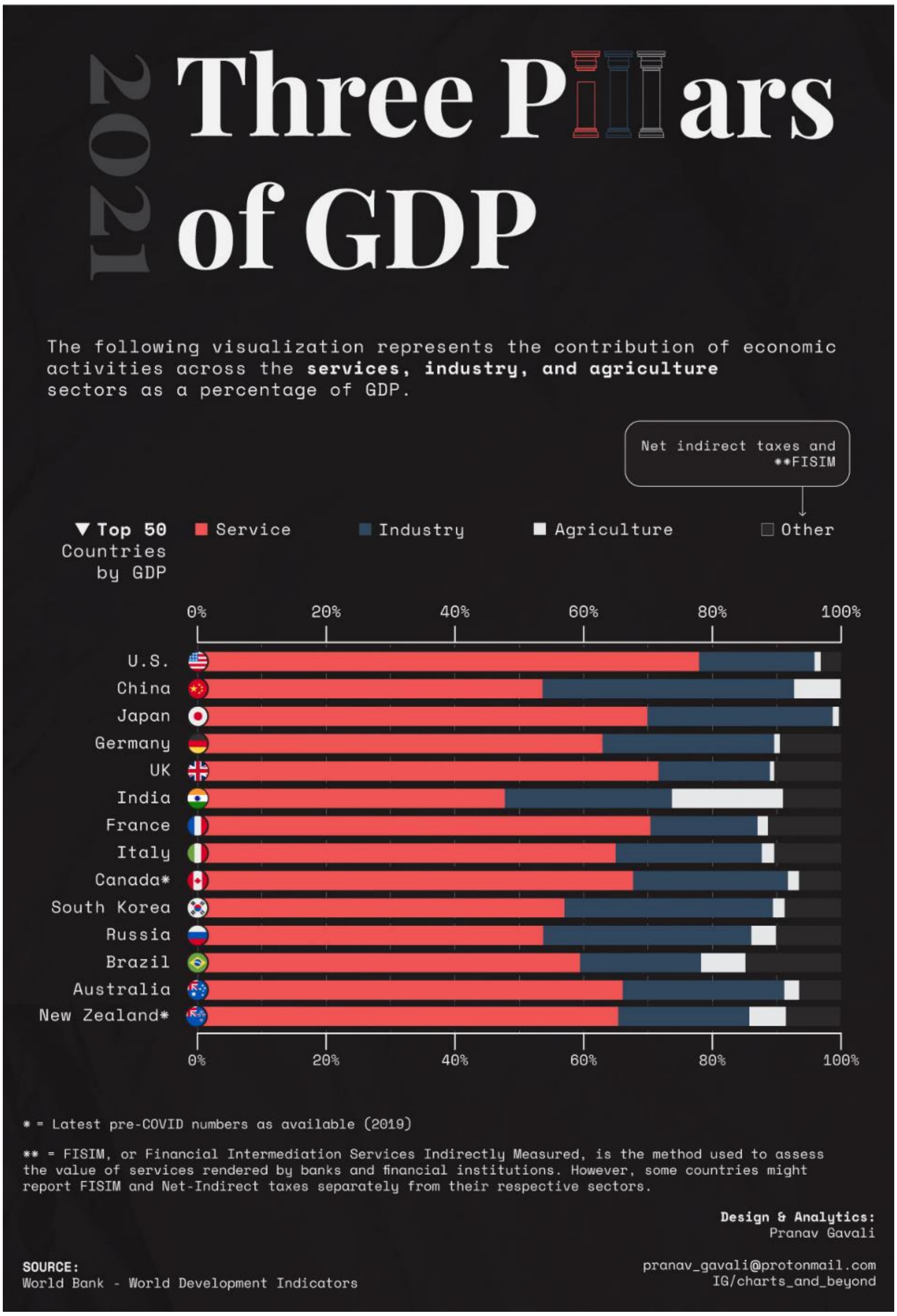
The US Senate passed a last-minute spending bill on 30 September to avert a government shutdown, which would have had a devastating impact on the country. The bill passed just three hours before the deadline and was signed into law by President Biden. The bill will keep the government open for 45 days, giving Congress more time to finish their funding legislation. Despite investors appearing relatively calm amid a recent stock market decline, which has led to the S&P 500 Index's first quarterly loss in a year, there are underlying signs of strain that extend beyond the narrowly avoided US government shutdown. It's not the severity of the market downturn that's causing concern, but rather the increasing frequency of significant down days and a notable absence of substantial rebounds. In the last quarter, three out of the six days when the S&P 500 recorded losses exceeding 1% occurred since mid-September, and there were just two instances of the index gaining more than 1% during the quarter. This three-to-two ratio of declines to gains is the highest it has been since 1994 according to Bloomberg. Events in the US share market have a significant impact on global investment markets, due to the size and importance of the US economy and its stock market (Figure 1).

Figure 1



The US' emergency oil reserve has reached its lowest level in 40 years, leading to constraints on Washington's ability to protect consumers from the consequences of Saudi Arabia's aggressive reduction in oil supplies, according to Goldman Sachs. Daan Struyven, head of oil research at Goldman Sachs, explained that the US has fewer options and tools in its energy policy toolkit at this juncture. This situation is one of the factors contributing to Goldman Sachs' projection of high oil prices, with an expected average of $100 per barrel by the same time next year. Such triple-digit oil prices would exacerbate the already elevated costs at the gas pump, further fuelling inflation and potentially influencing the outcome of the 2024 presidential race. The service sector, which accounts for about 80% of the US economy (Figure 2), is closely linked to oil prices. This is because the service sector is a major consumer of oil, particularly through the transportation sector.

Figure 2



The ECB has raised interest rates at each of its past ten meetings, but it has signalled that it will pause rate hikes in October. This has led to a debate among policymakers over whether the ECB is done hiking rates or if further tightening is on the table. Inflation fell to 4.3% in September from 5.2% a month earlier, which is a bigger-than-expected drop. This should fuel confidence that the rate of price growth is indeed coming back down. However, price growth is seen levelling off next year and holding broadly steady at around 3% for much of 2024, mostly due to governments unwinding subsidies. The big question is whether deflation can resume into 2025 and get back to 2% by the close of that year.

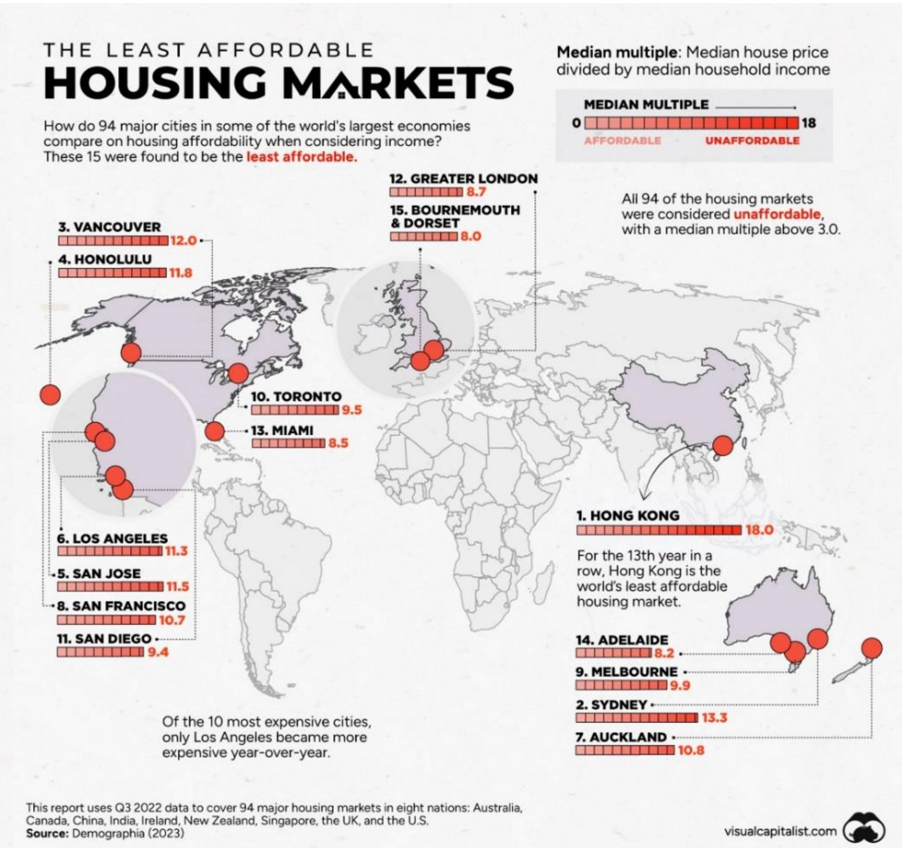
LOCAL SNAPSHOT

Considering the potential coalition scenarios following the General Election on 14 October, many analysts believe that the immediate economic prospects are unlikely to experience significant shifts, irrespective of the election outcome. This assessment is based on the current state of public finances, characterized by an OBEGAL (operating balance before gains and losses) deficit, even though the economy is performing above its usual pace. Furthermore, there seems to be limited inclination from both the National and Labour parties to pursue decisive measures aimed at reducing expenditures or increasing revenue to achieve a surplus before the fiscal year 2026/27.

The RBNZ has decided to maintain the OCR at 5.5%. While the timing before the upcoming elections and the unavailability of third-quarter inflation data until 17 October had led most economists to anticipate a rate hold, the possibility of a rate hike wasn't completely dismissed, and a more assertive tone from the RBNZ had been expected. The Monetary Policy Committee of the central bank acknowledged the potential need to keep interest rates at a restrictive level for a more extended period.

The New Zealand housing market experienced a consistent decline in average asking prices, even though there have been discussions for several months suggesting that housing prices may have stabilized. According to the most recent information from realestate.co.nz, there was a 5.3% decrease in the national average asking price in the year to September, bringing it to $871,400. Additionally, the average asking price saw a marginal 0.1% decline compared to the previous month. Despite the decline, New Zealand is among least affordable housing markets in the world (Figure 3).

Figure 3



WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was down 3.7%, and MSCI Emerging Markets returned -1.8% in September in local currency terms.

The S&P 500 Index closed September with a decline of 4.9%, influenced by rising interest rates, which impacted on investor confidence. Among the index sectors, utilities saw the most significant decrease in value, while energy stocks, conversely, exhibited relatively better performance. The Nasdaq Composite Index returned -5.8% in September.

In September, the MSCI Europe ex UK Index decreased 2.5%, driven by apprehension that interest rates could remain elevated for an extended period and a sluggish Chinese economy. This decline also affected major country-specific stock indices. Germany's DAX Index experienced a 3.5% slide, France's CAC 40 Index dipped by -2.4%, but the FTSE 100 Index returned a positive 2.4% over the month.

Chinese equities declined over the month, primarily due to a scarcity of favourable economic updates which had a dampening effect on investor confidence. The Shanghai Stock Exchange Index recorded a loss of 0.2% in September.

Australian large-cap stocks experienced a significant sell-off, declining by 2.8% over the course of the month. Mid-cap and small-cap stocks fared even worse than their larger counterparts during the same period. Meanwhile, New Zealand's S&P/NZX 50 Index performed slightly better than the Australian market, with a 2.2% decline for the month.

Fixed Interest

Elevated oil prices raised worries that controlling inflation might become a more challenging task for central banks, prompting a bond sell-off. Additionally, concerns about a potential US government shutdown contributed to a downturn in investor confidence. On 27 September, the yield on the 10-year U.S. Treasury note reached a high point, exceeding 4.6%. However, following the release of positive inflation data from both the eurozone and the US, yields saw a modest decline. Over the month of September, the 10-year Treasury yield increased, ending at 4.57%.

European government bond yields saw a general upward trend as investors paid attention to the prevailing notion of prolonged higher interest rates in financial markets. Germany's 10-year bund yield surged to nearly 3%, a level not witnessed in over a decade, before experiencing a pullback to 2.84%. Meanwhile, in the UK, the yield on the 10-year gilt reached above 4.5% before retracting on the last trading day in September and settling at 4.44%.

Australian fixed income indices were down in September, as were their counterparts in New Zealand.

GEOPOLITICS

The rapid fall of Nagorno-Karabakh to Azerbaijani forces and the subsequent scramble of its ethnic Armenian population to evacuate have been remarkably sudden, considering the region's history of intermittent wars and fragile ceasefires. The Azerbaijani offensive commenced on 19 September, launching missiles and drones at the regional capital of Stepanakert, marking the start of the third conflict over control of the area in three decades. Under the Soviet Union, to which both Azerbaijan and Armenia belonged, Nagorno-Karabakh was an autonomous region within the Republic of Azerbaijan. Tensions escalated in 1988 when Karabakh officials declared their intention to join the Republic of Armenia, sparking the First Karabakh War as the Soviet Union crumbled. Over six years, around 30,000 people lost their lives, with the Armenian side eventually gaining control in 1994. After sporadic clashes, the Second Karabakh War erupted in 2020, resulting in Azerbaijan, with Turkey's support, reclaiming a third of Karabakh in just 44 days before a Russian-brokered ceasefire. However, the third war lasted only a day, with Karabakh's surrender leading to its dissolution, marking the end of decades of conflict and potentially centuries of Armenian presence in the region. The president of Nagorno-Karabakh signed a decree dissolving state institutions, with the region ceasing to exist from 1 January 2024.

The UK's Ministry of Defence has allocated nearly £4 billion (NZ$4.9 billion) in funding to BAE Systems Plc for the next phase of the UK's nuclear-powered attack submarine program. This decision comes after the leaders of Australia, the UK, and the US committed in March to cooperate on the submarine fleet, a move aimed at countering China's increasing assertiveness in the South China Sea and around Taiwan. Known as SSN-AUKUS, this program is set to introduce the Royal Navy to the largest, most advanced, and powerful attack submarines it has ever operated, according to a statement by BAE Systems. Secretary of Defence Grant Shapps announced this investment while highlighting Britain's military capabilities on the opening day of the Conservative Party Conference. The funding will cover development work until 2028, with manufacturing scheduled to commence later in the decade and the first SSN-AUKUS submarine expected to be delivered in the late 2030s, following design work that began in 2021. The arms race between West and East is hotting up.

In a significant development, a pro-Russian populist has secured a pivotal election victory in the heart of Europe, offering President Vladimir Putin a boost in his regional influence, while concerns arise about weakening Western support for Ukraine amid signs of division in Washington. The outcome of this election in Slovakia, a historically staunch ally of Kyiv, could potentially lead to a shift in its stance at a critical juncture, heightening anxiety among Western nations about waning public enthusiasm for the ongoing conflict, exacerbated by the absence of new funding for Ukraine in the eleventh-hour US government deal. Robert Fico's SMER-SSD Party, unexpectedly claiming 23% of the vote on 30 September, now finds itself in a position to potentially form a government. The outcome of the election on 15 October in Poland will also have a significant impact on EU foreign policy. If the ruling Law and Justice (PiS) party wins the election, Poland is likely to continue its tough stance towards Russia. If the Donald Tusk-led opposition wins the election, it is possible that Poland's relations with Russia could improve. Hungary, Slovakia, Poland … next?

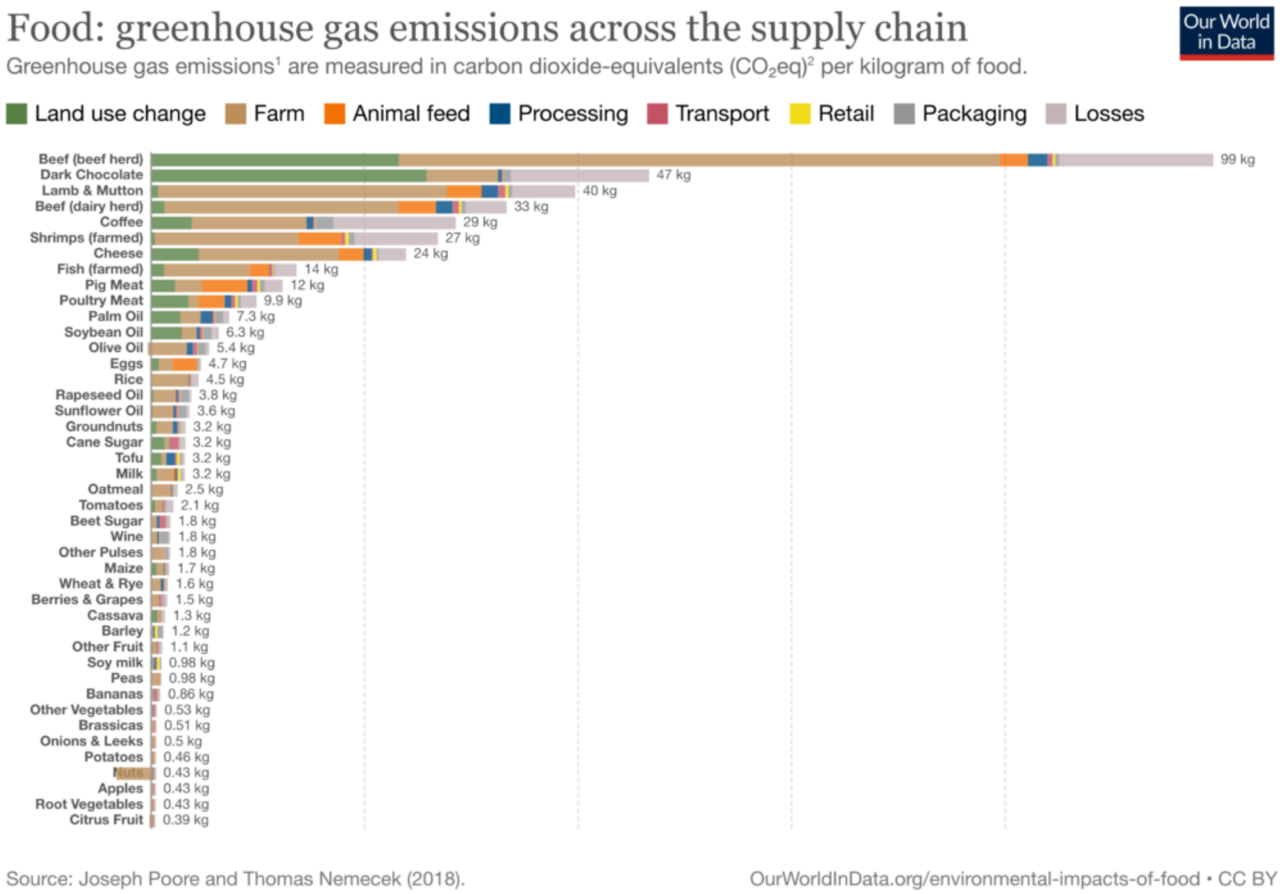
DECARBONISATION: FOOD

While large businesses and countries have pledged to achieve net-zero emissions, our everyday activities also contribute to global emissions. Transportation is a major factor in our carbon footprint. For example, commuting 15km to work by public transport produces 1,464 grams of CO_2 emissions per day, compared to 3,360 grams by car. Our food consumption also has a significant impact, with an average of 4,500 grams of CO2 emissions per day (Figure 4).

Figure 4

Our dietary preferences, agricultural practices, food sourcing and resource utilisation are all significant determinants of our contribution to climate change as humans. The ramifications of animal agriculture are extensive and substantial. For those readers inclined towards a quantitative perspective, the accompanying chart provides a comprehensive illustration of emissions across the food supply chain (Figure 5).

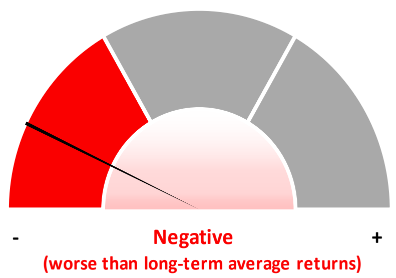
Figure 5



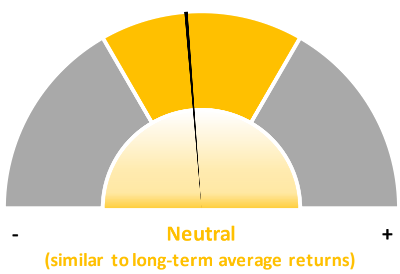
MARKET OUTLOOK

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