ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – DECEMBER 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	7,679.05	4.2	9.8	23.1
MSCI World NR (NZD)	15,613.10	2.3	5.7	23.7
MSCI Emerging Markets	689.37	3.1	5.6	9.9
S&P 500 (US)	4,769.83	4.4	11.2	24.2
Nikkei 225 (Japan)	33,464.17	(0.1)	5.0	28.2
FTSE 100 (UK)	7,733.24	3.7	1.6	3.8
DAX (Germany)	16,751.64	3.3	8.9	20.3
CAC 40 (France)	7,543.18	3.2	5.7	16.5
Trans-Tasman Equities				
S&P/NZX 50	11,770.49	3.9	4.2	2.6
S&P/ASX 300	94,385.90	7.2	8.4	12.1
Bonds				
S&P/NZX NZ Govt Stock	1,737.72	3.6	7.3	5.4
S&P/NZX A Grade Corporate	5,820.29	2.2	5.0	7.4
Barclays Global Agg (Hedged to NZD)	400.62	3.1	5.7	6.6
Oil and Gold				
West Texas Intermediate Crude	71.65	(5.7)	(21.1)	(10.7)
Brent Crude	77.60	(3.7)	(19.4)	(8.7)
Gold	2,062.98	1.3	11.6	13.1
NZD Foreign Exchange				
AUD	0.9279	(0.4)	(0.3)	(0.5)
EUR	0.5728	1.2	0.9	(3.3)
GBP	0.4966	1.8	0.9	(5.5)
JPY	89.2666	(2.2)	(0.4)	7.0
CNY	4.5046	2.1	2.8	2.9
USD	0.6329	2.5	5.3	0.1

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

Executive summary:

- Both bonds and equities continued to rally through December, ending 2023 in the black.
- The ongoing HAMAS-Israel war could escalate to a broader regional conflict.
- Oil prices dropped below $80 per barrel.
- The NZD appreciated against all major currencies except the AUD and JPY.

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ECONOMIC COMMENTARY

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12 January 2024

2024 OUTLOOK

Many analysts from multinational banks and consulting firms are forecasting a soft landing in the US in 2024. This could reflect the large reduction in longer term interest rates in the past two months, but in particular the last two weeks of 2023.

The 10-year US Treasury yield fell from 5% to 3.4%! This boosted both equity and bond prices. Markets are pricing in that sort of level of reduction in the US Fed's cash rate for this year.

We expect yield curves to steepen further and equity markets to correct significantly this year. We are not sure when though, obviously.

Inflation is accelerating in the eurozone, pushing back any potential interest rate cuts. Supply chain constraints due to the escalating war in the Middle East and migration will keep inflation rates higher in most countries, including New Zealand.

In that sense we expect the price of oil to range between $75 - $95 per barrel because of OPEC, shipping disruptions and climate change, with the latter increasing the need for heating in the winter or cooling in the summer.

Geopolitical and political instability is increasing around the world as we head into an election year in many countries, including Taiwan, Indonesia, Russia, South Korea, India, South Africa, the EU, Mexico, the UK and the US.

There has been a swing to the right in Argentina, the Netherlands and New Zealand, but voters want change. It will be interesting to see how politicians and central bankers handle the pressure.

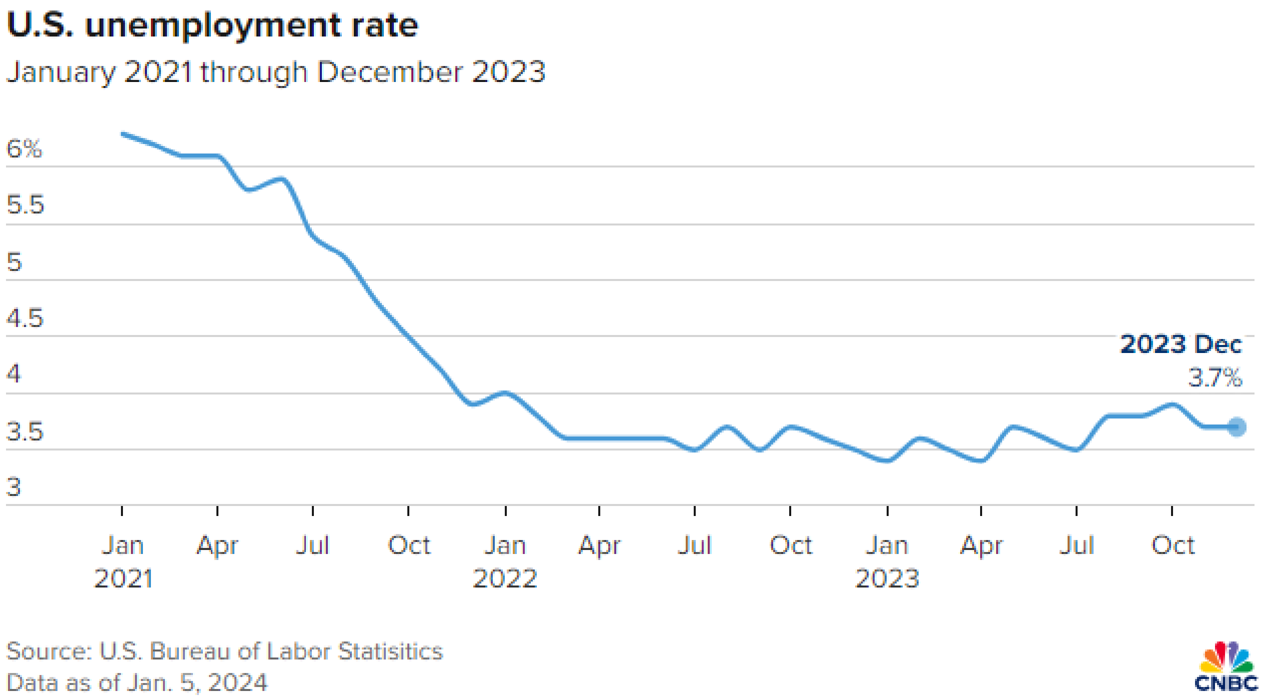
GLOBAL SNAPSHOT

Global markets defied doom and gloom in 2023, with stocks bouncing back from early-year jitters on bets of a US economic soft landing. Fuelled by falling inflation and improving corporate profits, major indices climbed double digits, except for Britain's FTSE 100 which lagged behind. As the year's dust settled, worries about a downturn faded, replaced by relief at US resilience, even as China and Europe remained slower on the uptake. While geopolitical conflicts continued, the year celebrated innovation, with AI-linked firms stock prices soaring amid investors' faith in the technology's potential.

2023 was a tale of two markets: tech soared with the Nasdaq climbing 55%, while broader gains since November lifted the equal-weighted S&P 500 by 12%. However, beneath the surface, individual stock returns have diverged dramatically since 2020, fuelled by macro jitters, geopolitical unrest and structural shifts. This dispersion reflects a disconnect between market expectations and reality. Investors had initially bet on rate cuts due to fears of a recession but rising government spending and labour shortages exposed inflation's resilience, pushing interest rates above pre-pandemic levels. Bond yields peaked near 5% in October - then plunged - as the Fed finally acknowledged the need for future rate cuts. Ultimately, 2023 highlighted the volatility and complexity of a new market regime where individual stocks are dancing to their own tunes amid the macro-orchestra.

The US labour market concluded 2023 on a robust note, surpassing expectations with a vigorous pace of hiring in December, according to the Labor Department. In December, employers added 216k positions, maintaining the unemployment rate at 3.7% (Figure 1). Payroll growth exhibited a significant increase compared to the downwardly revised 173k in November, with October also revised lower to 105k from 150k, indicating a marginally less robust growth picture for the fourth quarter. The report highlighted gains in government jobs (52k), health care-related fields (38k), leisure and hospitality (40k), social assistance (21k), and construction (17k). Retail trade added 17k jobs, with the industry experiencing relative stability since early 2022. However, transportation and warehousing saw a decline of 23k jobs. The report also underscored persistent inflationary pressures in the labour market, with average hourly earnings rising 0.4% for the month and 4.1% from a year ago, exceeding estimates of 0.3% and 3.9%, respectively. The average workweek slightly decreased to 34.3 hours.

Figure 1



On 7 January, House Speaker Mike Johnson and Senate Majority Leader Chuck Schumer revealed an agreement regarding the US government's budget for the upcoming year, marking a crucial advancement in averting a shutdown. Although the consensus on the overall spending level addresses a deadlock that had hindered progress, it doesn't automatically eliminate the possibility of a shutdown, especially as the initial of two deadlines on 19 January approaches, when certain government sectors risk running out of funds.

Hungary tried to quell speculation surrounding the possibility of Prime Minister Viktor Orban (known for his frequent conflicts with the EU) temporarily assuming a crucial role within one of the bloc's key bodies. With Hungary set to hold the EU's rotating six-month presidency from July, existing rules within the bloc indicate that Orban could temporarily lead if members fail to reach a consensus on the current European Council President's successor, who is planning to step down early to participate in the European Parliament elections set for June.

LOCAL SNAPSHOT

The 2024 World Economic Situation and Prospects report by the United Nations anticipates a gradual decline in inflation in New Zealand over the next year. Despite an initial projection of "relatively high" inflation in 2024, attributed to rising rental prices fuelled by housing supply shortages, the report indicates a decrease in the country's consumer price index to 3.4% in 2024, further dropping to 2.6% in 2025. The document highlights challenging economic conditions in New Zealand and other developed economies in the Asia-Pacific region. The report attributes weakened external demand from major trading partners, including the United States and China, and domestic demand constraints due to monetary tightening in Australia, New Zealand, and the Republic of Korea, as factors contributing to these economic challenges. The UN predicts that New Zealand's GDP growth in real terms for 2023 will be 1%, down from 2.7% in 2022. They expect a slight increase to 1.1% in 2024 and 2.2% in 2025.

As of 12 December, Stats NZ reported that annual net migration had surged to a record-breaking 128,900 individuals in the year ending 31 October, approximately twice the pre-COVID peak. In a committee session, RBNZ governor Adrian Orr expressed concern over the "extremely high" levels of net migration, noting that while per-capita consumption is decreasing, overall demand is on the rise. This raises the question of whether more prolonged monetary policy restrictions are necessary. Additionally, Orr highlighted the RBNZ's apprehension regarding the potential impact on housing and other asset prices resulting from this unprecedented influx of migrants.

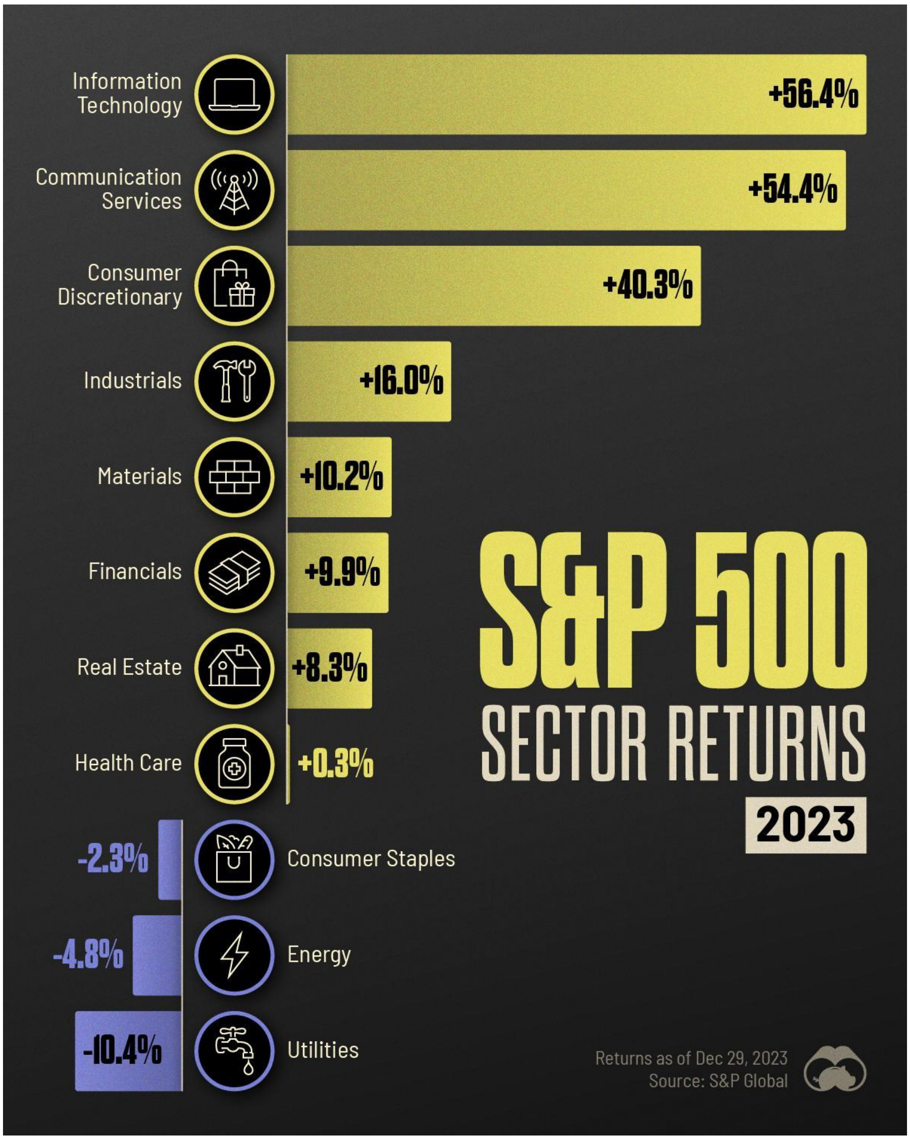
WORLD FINANCIAL MARKETS

Equities

The MSCI World Index rose by 4.2%, and MSCI Emerging Markets was up 3.1% in December in local currency terms.

The S&P 500 was up 4.4% in December, bringing its one-year return to 24.2%. Throughout 2023, the Magnificent 7 stocks achieved a remarkable average return of 111%, strongly outperforming the broader S&P 500. The information technology sector experienced a significant surge which was driven by the AI trend, resulting in triple-digit gains for stocks like NVIDIA and AMD (Figure 2). Tech giants Apple and Microsoft, holding substantial weights in the index, also posted over 50% gains for the year. Concurrently, in the communication services sector, stellar performances from Meta (+188%), Netflix (+63%), and Alphabet (+57%) contributed to the sector nearly matching the top spot. Notably, Netflix's strategic moves, including a crackdown on password-sharing leading to subscriber growth and revenue expansion through ad-tier offerings, positioned the streaming service as a formidable player in the industry, particularly given the financial struggles of its competitors. In consumer discretionary, robust performances by heavyweights Amazon and Tesla secured the sector's solid standing in third place. Additionally, travel companies such as Royal Caribbean Cruises, Carnival, and Booking Holdings reported strong returns, contributing to the sector's overall performance.

Figure 2



The Nasdaq Composite achieved an impressive annual increase of 43.4%, marking its strongest performance since 2020. Investor confidence grew throughout the year, supported by falling interest rates and robust labour data, fostering optimism about a potential "soft landing" for the US economy, avoiding a recession. Consequently, the market rally expanded in the fourth quarter, witnessing record highs in December for the industrial-focused Dow. The small-cap Russell 2000 experienced a notable uptick, surging over 12% in December, marking its best month since November 2020 and securing its most robust quarter since the fourth quarter of 2020.

In December, the MSCI Europe ex UK Index rose by 3.9%, reaching a one-year return of 18.5%. This was on hopes of softer monetary policy from major central banks in 2024. European stocks ended last session in the green, marking a positive end to a solid year with Germany's DAX Index rising by nearly 20% and France's CAC 40 Index gaining 16.3%. Additionally, the UK's FTSE 100 ended the year with a 3.6% increase, yet it trailed behind the majority of its European counterparts.

Boosted by declining inflation and the prospect of reduced interest rates, Australia's S&P/ASX 200 achieved its most substantial monthly gain in three years, surging by 7% in December. The benchmark concluded 2023 with a 12% increase, coming within a mere 0.3% of reaching a new record high. In contrast, New Zealand's S&P/NZX 50 Index experienced a more moderate ascent, with a 3.9% gain in December, ultimately steering the index's annual return into positive territory, closing the year with a 2.6% gain.

Fixed Interest

A substantial two-month surge in bond prices, driven by anticipations of imminent interest rate cuts by central banks, has prevented fixed income markets from experiencing an exceptionally rare third consecutive year of declines. The US 10-year Treasury yield, a global benchmark for borrowing costs, declined by 46 basis points (bps) in December, following a drop of 53 bps in November. This two-month decline is the most significant since 2008, a period marked by the Federal Reserve's rate cuts during the global financial crisis.

In 2023, Germany's 10-year yield experienced its most substantial decline since 2014, dropping by 55 bps. The majority of this decrease occurred in November and December, attributed to a more significant-than-anticipated slowdown in inflation and indications from the European Central Bank that its rate-hiking cycle was nearing completion. Bond traders noted pronounced fluctuations, particularly in the waning weeks of December when thin liquidity conditions contributed to the Bund yield briefly falling below 2% before swiftly rebounding above that threshold. Concurrently, Italy's 10-year government bond yield reached 3.468%, marking its lowest level since August 2022.

In December, fixed income indices in Australia and New Zealand have once again maintained positive positions, following the global trend of declining rates from their October highs. Throughout 2023, all the fixed income indices reported in the region yielded positive returns. Notably, the standout performers were inflation-linked government bonds, securing gains of 8-9% for the year.

GEOPOLITICS

Here we present the key events that shaped the world in 2023 and their potential impact on investors:

- The war in Ukraine and other ongoing conflicts continue to cast a shadow over the global economy;
- The rise of far-right parties in countries like Italy and Sweden is a worrying trend for democracy;
- India's ascent to become the world's most populous country has major implications for the global balance of power and economic growth; and
- The ongoing war in Ukraine and the increasing demand for clean energy are putting a strain on global resources, leading to price hikes and potential supply chain disruptions.

2023 was a year of record-breaking international turmoil, with conflicts, famines, and refugee flows reaching unprecedented levels. These trends are poised to continue in 2024, but amidst the chaos, a glimmer of hope emerges: elections. Over 60 countries will hold polls this year, making it the "ultimate election year." These elections offer a crucial litmus test for the global state of democracy, which has been under increasing scrutiny in recent years.

Elections hold immense significance when conducted freely and fairly, with the loser accepting the outcome. With this in mind, concerns linger that 2024 could be a year of setbacks for the democratic process. Some elections, like Russia's, are mere formalities, while others, like Iran's, are overshadowed by powerful unelected figures. Still, several elections hold the potential for significant change, potentially altering international relations.

From the potential flashpoint of Taiwan's presidential election, amidst Xi Jinping's rhetoric of unification, to the world's largest democracy in India wrestling with Modi's Hindu-nationalism, 2024 paints a diverse canvas of elections with global consequences. The UK's uncertain "Global Britain" path hinges on Prime Minister Sunak's upcoming polls, while war-torn Ukraine faces the delicate dance of holding mid-war elections. Then, there's the blockbuster duel in the US, where Biden and Trump's rematch will reshape foreign policy, climate action, and immigration for years to come. Whether these elections ignite change or stoke instability, the world watches with bated breath.

China's Belt and Road Initiative (BRI) has pumped billions into African infrastructure, building roads, ports, and railways with an eye on the continent's vast mineral resources. With over 80% of DRC copper mines now Chinese-owned, Beijing has secured a significant foothold. In response, the US is pushing its own Lobito Corridor project, a new railway aiming to divert those resources westward to Atlantic markets. The stakes are high as both US and Europe scramble to secure raw materials crucial for the energy transition. The race is on to control African resources, with one eye on infrastructure and the other on the green future.

While China has long dominated African infrastructure thanks to the BRI, their economic struggles open a window for the US and Europe to counter with their own projects like the Lobito Corridor. Global entities like the World Bank and African Development Bank are joining the fray, recognising the vital role infrastructure plays in unlocking the continent's economic potential and securing minerals crucial for the green transition. However, China's lead remains significant, with their ubiquitous projects woven into the daily lives of many Africans. Replacing them likely isn't the goal, as African nations prioritise creating and keeping value within their borders. Ultimately, this evolving landscape promises increased connectivity, resource access, and potentially a more diversified landscape for African development, as competing powers jostle for influence.

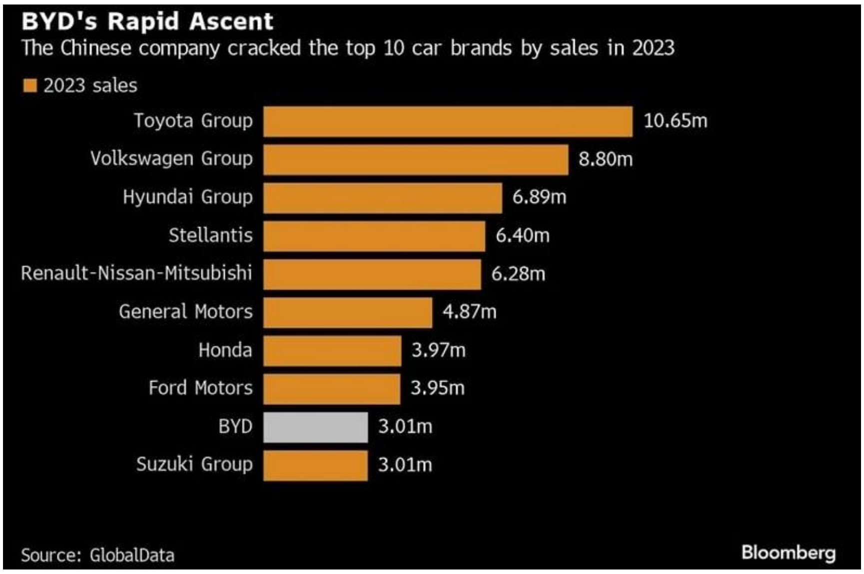
EV RACE

China's electric vehicle juggernaut is revving up, with BYD dethroning Tesla as the world's top seller and its peers poised to join the party. Analysts predict a wave of affordable, high-tech Chinese EVs sweeping across Europe, potentially sparking a global electric revolution, leaving western competitors in the dust. But the US, shielded by domestic policies, seems safe for now. This rapid rise has sparked anxieties in the west, with investigations and potential tariff hikes brewing. One thing's clear: the electric race is shifting gears, and China is determined to take the lead.

BYD roared towards electric vehicle dominance in the final quarter of 2023, outpacing Tesla with a record 526,409 all-electric car sales. This surge, fuelled by year-end discounts, puts immense pressure on Tesla to deliver a phenomenal performance and retain its top spot. Analysts predict Tesla might land around 483,200 units, potentially salvaging its 1.8 million target with a boost from the revamped Model 3 and the Cybertruck.

BYD's overall 2023 performance is even more staggering. Their 3.01 million combined EV and hybrid sales nearly doubled their totals from the past five years and propelled them into the global top 10 (Figure 3). Not only that, but their aggressive expansion plans saw them choose Hungary for their first European car plant, aiming to flood the continent with affordable EVs despite potential trade tensions. It's clear that BYD is playing hard to win, and Tesla better buckle up for a thrilling electric race in the years to come.

Figure 3



GLOBAL SUPPLY CHAIN: WEAKEST LINKS

The global supply chain, a seemingly invisible engine humming behind our interconnected world, operates on thin margins with critical chokepoints holding the potential to throttle entire economies. From the majestic arteries of the Suez and Panama Canals to the unpredictable currents of the Red Sea, these chokepoints expose the delicate underbelly of global trade, vulnerable to the vagaries of a wayward vessel, a parched canal bed, or even a band of modern-day pirates.

The 2021 Suez Canal blockage, where a single container ship brought the world's commerce to a standstill, is a stark reminder of this fragility. It's not just the Suez, though. Rising piracy in the Red Sea, the Panama Canal's capacity constraints, and the looming spectre of drought further underscore the precariously balanced nature of this vital system.

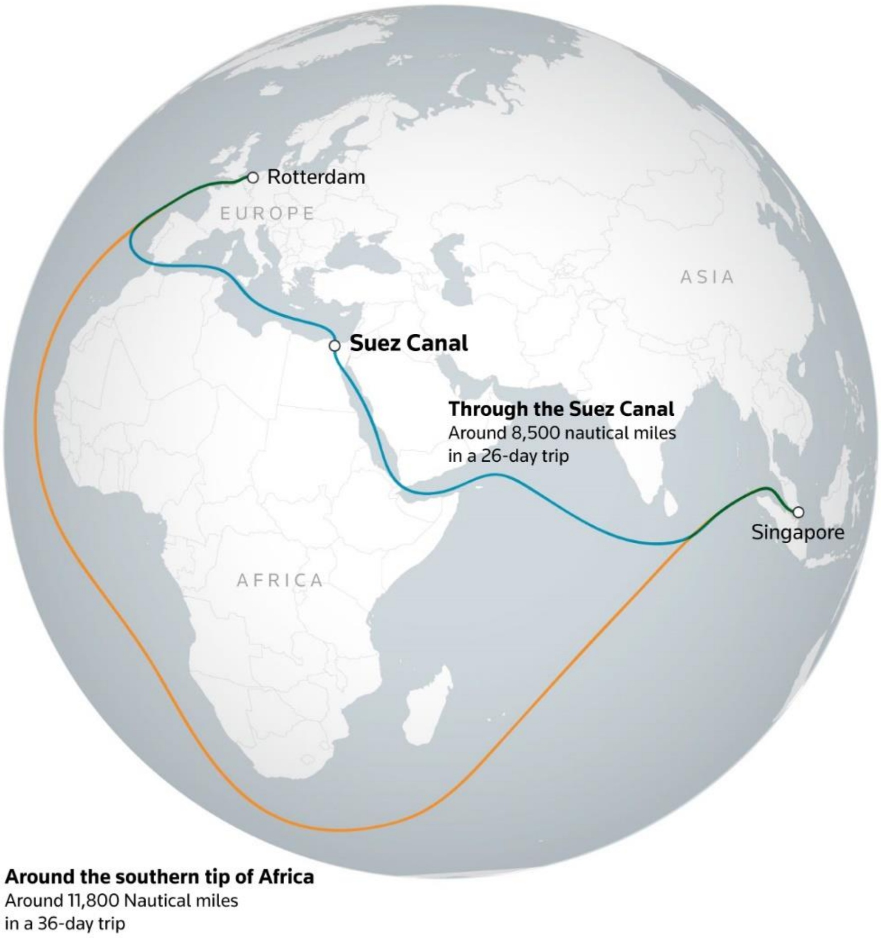
Heavily armed Yemeni rebels pose a new threat to Red Sea shipping, prompting naval patrols, armed guards on board vessels, and re-routed journeys. Unlike Somali pirates of the past, the Houthis boast superior firepower and tactics, making them a tougher adversary. Framing the Houthis as "pirates" allows Western powers to justify potential military action without acknowledging complex regional dynamics, but limited international cooperation and growing industry anxiety suggest navigating this new threat will be far more challenging than quelling Somali piracy a decade ago.

Sailing around Africa instead of using the Suez Canal, a route relied on by a third of global container ships, could raise fuel costs by a staggering $1 million per round trip between Asia and Northern Europe, significantly impacting shipping expenses (Figure 4).

Figure 4

Vessels re-routing

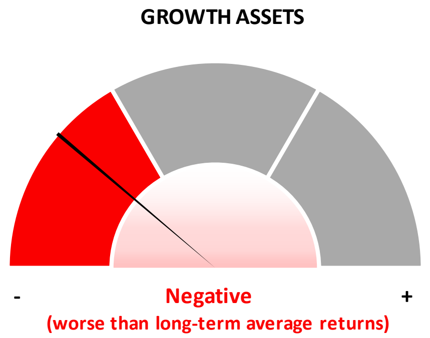
Attacks by Yemen's Houthi militants on ships in the Red Sea are disrupting maritime trade through the Suez Canal, with some vessels re-routing to a much longer East-West route via the southern tip of Africa.

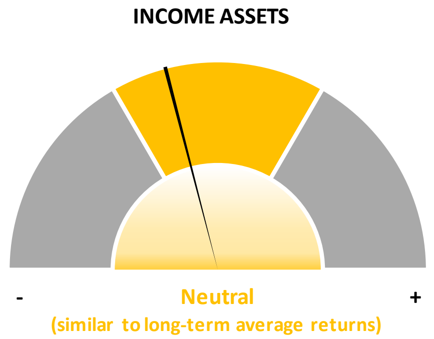


Sources: LSEG; Planet Labs; Maps4News; Shoei Kisen Kaisha
Reuters Staff • Dec. 19, 2023 | REUTERS

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 and Australasian bonds
- Cash and term deposits
- Other debt instruments