ERIKSENSGLOBAL
Actuaries & Investment Consultants

2024

April Market Performance and Economic Commentary

Market Performance

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	8,180.09	(3.2)	4.7	20.2
MSCI World NR (NZD)	17,513.37	(2.7)	7.8	23.6
MSCI Emerging Markets	730.44	1.4	9.8	12.9
S&P 500 (US)	5,035.69	(4.2)	3.9	20.8
Nikkei 225 (Japan)	38,405.66	(4.9)	5.8	33.1
FTSE 100 (UK)	8,144.13	2.4	6.7	3.5
DAX (Germany)	17,932.17	(3.0)	6.1	12.6
CAC 40 (France)	7,984.93	(2.7)	4.3	6.6
Trans-Tasman Equities				
S&P/NZX 50	11,957.50	(1.2)	0.7	(0.5)
S&P/ASX 300	96,598.39	(2.9)	1.2	9.0
Bonds				
S&P/NZX NZ Govt Stock	1,710.51	(1.4)	(0.6)	0.1
S&P/NZX A Grade Corporate	5,818.61	(0.6)	0.4	4.0
Barclays Global Agg (Hedged to NZD)	393.98	(1.6)	(1.4)	1.6
Oil and Gold				
West Texas Intermediate Crude	81.93	(1.5)	8.0	6.7
Brent Crude	87.86	1.0	6.2	8.1
Gold	2,286.25	2.5	12.1	14.9
NZD Foreign Exchange				
AUD	0.9110	(0.6)	(2.2)	(2.6)
EUR	0.5533	(0.1)	(2.4)	(1.1)
GBP	0.4724	(0.2)	(2.3)	(3.9)
JPY	93.0763	2.8	3.4	10.7
CNY	4.2893	(1.2)	(2.9)	0.3
USD	0.5915	(1.1)	(3.9)	(4.2)

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

Executive summary:

- Global equities sold off ending the rally which began in early January 2024.
- Iran-Israel tensions are on the brink of escalating into a full-scale conflict.
- The NZD depreciated against all major currencies for the second consecutive month except JPY.
- Gold has reached new record highs, driven by significant purchases from the central banks of China, Russia, India and Saudi Arabia.

Economic Commentary

Authored by Janibek Issagulov and reviewed by the Eriksens team.
15 May 2024

Global Snapshot

According to a Bloomberg analysis that ran a million forecast simulations on the US debt outlook, the US is facing a concerning trajectory, with 88% of simulations indicating an unsustainable path of borrowing (Figure 1). This revelation follows the Congressional Budget Office's forecast, predicting a mind-boggling $54 trillion of national debt within the next decade, driven by factors such as an aging population and increasing healthcare costs, compounded by rising interest rates. The projections indicate a tripling of payments from $475 billion in fiscal year 2022 to a staggering $1.4 trillion by 2032, with interest payments projected to reach $5.4 trillion by 2053, surpassing spending on major programs like Social Security and Medicare. Bloomberg's analysis suggests that by 2034, the debt-to-GDP ratio could rise to 123%, and in a more pessimistic scenario, it could climb to 133.9% by 2034 and 185% by 2050. Such levels of debt could potentially jeopardise America's global economic position.

Figure 1

Investors were notably alarmed by the latest inflation figures, fuelling concerns that the US could be entering a period of "stagflation", characterised by simultaneous inflation and economic stagnation. The Commerce Department disclosed that its core Personal Consumption Expenditures (PCE) Index, excluding food and energy, surged at an annualised rate of 3.7% in the first quarter, surpassing expectations significantly. This increase far outpaced the 1.7% rise seen in the fourth quarter and exceeded the Fed's long-term inflation target of 2%. The Employment Cost Index showed a 1.2% increase in the last quarter, following an unrevised 0.9% rise in the fourth quarter, with labour costs rising by 4.2% on a year-on-year basis. This report came after recent data indicated growing price pressures in the first quarter.

On 1 May the Fed announced its decision to maintain interest rates in the target range between 5.25% and 5.5% due to persistent inflationary pressures affecting the US economy. Despite expectations from some quarters for rate cuts, given that interest rates are currently at their highest since 2007, inflation has remained stubbornly above the Fed's target rate of 2%, hovering around 3% annually. The Fed's statement reiterated its stance from the previous meeting in March, indicating a reluctance to reduce the target range until there is more confidence in inflation trending sustainably towards the 2% mark. The statement highlighted the Fed's commitment to monitor incoming data, economic outlook changes, and risk assessments closely. Although inflation temporarily dipped to 3% last June, it has fluctuated between 2% and 4% in recent months, with January seeing a drop to 3.1% from December's 4.1%, raising hopes among investors for potential rate cuts later in the year. However, inflation rebounded in February and in March reached 3.5%.

The Bank of England (BoE) announced its latest hold decision on interest rates on 9 May, which has been steady at 5.25% for several months. Inflation, as measured by the Consumer Price Index, fell to 3.2% in March and is anticipated to approach the Bank's 2% target rate in April, partly due to declining energy prices. Concurrently, data from the British Retail Consortium indicates a slowdown in annual shop price inflation, decreasing to 0.8% in April from 1.3% in March. A significant economic factor influencing the Bank's decisions could be the recent hike in the UK's minimum wage, with the national living wage rising nearly 10%. Some economists have expressed concerns that this increase might challenge efforts to maintain low inflation levels.

Following a period of synchronised interest rate hikes in 2022 and 2023, the monetary policy trajectories among major economies are now diverging. The Swiss National Bank (SNB) led the way by initiating an interest rate-cutting cycle, marking a significant departure from the trend of rate increases. The Swedish Central Bank followed. Similarly, two emerging-market central banks, Banxico (Central Bank of Mexico) and the Central Bank of Brazil, reduced rates in the first quarter of 2024 as inflationary pressures eased. SNB's rate cut of 25 basis points in March lowered its policy rate to 1.50%, marking its first reduction since December 2014 when rates entered negative territory. Concurrently, Banxico reduced its target rate by 25 basis points to 11.0%, joining Brazil's Central Bank, which had already begun easing its policy in August 2023, culminating in a 100-basis point reduction by the end of the first quarter of 2024. On the other hand, in Asia, the Bank of Japan shifted its policy rate out of negative territory in March, aiming for a range of 0.0%-0.1% due to more sustainable inflation trends. Meanwhile, Bank Indonesia raised its benchmark rate by 25 basis points to 6.25% in April. The Central Bank of the Republic of Turkey also raised its policy rate by a significant 500 basis points, from 45.0% to 50.0% in March, responding to rising inflation and the depreciation of the lira. Inflation hit 68.5% year-on-year in March, with the lira weakening to a record level in excess of TRY32 per dollar in April 2024. Ten years ago, TRY2 would buy one US dollar.

Local Snapshot

Stats NZ reported a 4% increase in the Consumer Price Index (CPI) over the year to 31 March, a decline from the previous 4.7% rise in December 2023 and a significant drop from the peak of 7.3% in June 2022. Housing costs, including rent and construction, were the major contributors to these recent figures. Rent prices saw the highest increase since tracking began in 1999, rising by 4.7%, while construction and rates increased by 3.3% and 9.8% respectively. Recreation and culture costs also rose due to higher prices for tourist accommodation and cultural services. Acting Finance Minister Chris Bishop called the inflation news "encouraging" but emphasised the need for continued economic efforts.

The labour market has shown signs of weakening, with the unemployment rate increasing to 4.3% during the March quarter. This uptick in unemployment has been gradual and has not been uniform across different age groups and industries. Wage pressures have been slow to alleviate, partly attributed to collective pay agreements that have led to public sector pay rates catching up with those in the private sector, along with the rising cost of living. Given the considerable slack in the current labour market compared to a year ago, the RBNZ anticipates a more notable deceleration in wage growth in the coming year.

In April, the average house price in New Zealand dropped slightly, with the 0.1% decline reflecting the uncertain state of the economic landscape, including inflation, interest rates, the labour market and confidence. CoreLogic's House Price Index registered this marginal decrease, with the average property value now standing at $933,633, showing a 3% increase from September's low but still nearly 11% below the peak. While some main centres like Dunedin, Wellington, and Hamilton experienced modest growth, others such as Christchurch, Tauranga, and Auckland remained relatively flat or saw slight declines. Kelvin Davidson, CoreLogic NZ's Chief Property Economist, noted that these soft price trends reinforce the perception of a 'buyers' market,' giving sellers less leverage in negotiations.

World Financial Markets

Equities

In local currency terms, the MSCI World Index went down by 2.6% over the month and the MSCI Emerging Markets went up by 1.4%.

The S&P 500 went down 3% in April, breaking a five-month streak of gains, driven by data indicating growing wage pressure that in turn fueled concerns about inflation. This trend coincided with the Federal Reserve's third meeting getting underway. Labor costs in the U.S. surged beyond expectations in the first quarter, primarily due to increasing wages and benefits, intensifying worries about inflation precisely when investor expectations for Fed rate cuts were diminishing.

In Europe, the MSCI Europe ex UK index went down by 2.6%. The geopolitical tensions in Middle East and stickier inflation were reflected in the performance of major stock indexes, with Germany's DAX Index declining by 3%, France's CAC 40 Index by 2.7%. In contrast, the UK's FTSE 100 Index surged by 2.4% reaching new all-time highs during the month.

Australia's S&P/ASX 200 index paused its five-month streak of gains, ending the month with a 3% decline. Large-cap companies showed weaker performance, while emerging companies saw a 3% increase. Among the sectors within the S&P/ASX 200, real estate took the biggest hit, falling by 8%, while utilities experienced the most significant gain at 5%. Materials also maintained positive momentum, supported by strong metal prices. Meanwhile, across the Tasman Sea, New Zealand's S&P/NZX 50 dropped by 1.2%.

Fixed Interest

Following the publication of Personal Consumption Expenditures (PCE) data, the yield on the 10-year US Treasury note experienced a slight decline but closed the month on its highest level in nearly half a year. Throughout the month, the 10-year Treasury yield saw a 47-bps increase, climbing from 4.21% to 4.68%. Similarly, the 2-year Treasury yield rose by 41 bps, moving from 4.63% to 5.04%.

European government bond yields reached their peak for the year as a result of robust economic indicators from the US, leading to speculations that the Federal Reserve might prolong its higher interest rate stance. This scenario could prompt other major central banks to adopt similar measures. The 10-year German bund yield increased to 2.59% over the month.

In New Zealand and Australia bonds faced ongoing pressure due to persistent inflation in the first quarter, strengthening the argument for central banks to maintain higher interest rates for an extended period.

Geopolitics

On 13 April Iran launched over 300 drones and missiles towards Israel in its first direct attack on the country, claiming the attack was retaliation for an airstrike on an Iranian diplomatic building in Damascus on 1 April. According to Tehran, the Damascus airstrike resulted in the death of a senior figure in Iran's Islamic Revolutionary Guards and eight other officers. In response, Iran then launched 170 drones, more than 30 cruise missiles, and over 120 ballistic missiles towards Israel territory. The Israeli military spokesperson, R Adm Daniel Hagari, claimed that Israel and its allies intercepted 99% of the incoming barrage, with all drones and cruise missiles shot down before reaching Israel. However, some ballistic missiles did penetrate Israel's defences, causing minor damage to the Nevatim airbase in the southern Negev desert. Iran conducted the attack from its territory and also utilised projectiles from Iraqi, Syrian, and Yemeni territories, where Iranian forces and allied militant groups are active. Lebanon's Hezbollah movement, a key proxy of Tehran, also launched rockets at Israeli positions in the Golan Heights simultaneously with the Iranian assault and later in a second barrage. The US, a key ally of Israel, intervened to intercept incoming fire, with President Joe Biden noting that the US helped neutralise a significant portion of the drones and missiles. The UK also reported shooting down Iranian attack drones using RAF fighter jets as part of their Operation Shader mission against the Islamic State in Syria and Iraq. Iran claimed that its operation, named Operation True Promise, achieved its objectives and issued warnings of a larger-scale attack on Israel, including the targeting of US bases, if it was retaliated against. In response, Israeli officials vowed to hold Iran accountable for its actions, with Defence Minister Yoav Gallant calling for a strategic alliance against the perceived threat posed by Iran.

The subsequent Israeli retaliation strike on Iran on 19 April was initially intended to be more expansive, encompassing multiple military targets across Iran including areas near Tehran. However, due to strong diplomatic pressure primarily from the United States, Israel scaled back its plans. Three senior Israeli officials revealed that Israel had abandoned the idea of a broader counterstrike against Iran after successfully repelling the brunt of an Iranian assault on Israeli soil. The original discussions involved a substantial and potentially more damaging attack, which would have been challenging for Iran to ignore, potentially escalating into a major regional conflict. Following urging from President Biden, as well as British and German foreign ministers, Israeli Prime Minister Benjamin Netanyahu opted for a more limited strike, which minimized significant damage and reduced the likelihood of immediate escalation, at least for the time being.

Global leaders have been quick to condemn Iran's recent attacks on Israel, emphasizing the need for restraint to prevent a further escalation of tensions. The European Union's High Representative for Foreign Affairs and Security Policy, Josep Borrell, strongly denounced Iran's actions, describing them as an "unprecedented escalation" and a significant threat to regional stability. This sentiment echoes the broader international response, which has underscored the gravity of the situation and called for measures to de-escalate the conflict. However, there has been no Israelian military response to date.

Joe Biden has approved a bill that expedites $95 billion in foreign aid to Ukraine, Israel, and Taiwan, marking a bipartisan legislative victory he celebrated as a positive step for global peace. This achievement follows months of congressional deadlock that had jeopardised Washington's support for Kyiv in its efforts to resist Russia's invasion. The Senate overwhelmingly passed the measure with a 79-18 vote late on Tuesday, with similar strong support in the Republican-controlled House, despite initial resistance from a group of conservative isolationists opposed to aiding Ukraine. Biden also highlighted the bill's significance as an investment in America's industrial sector, particularly in states like Alabama, Arizona, Ohio, and Pennsylvania, where military equipment production facilities are located. The aid arrives at a crucial juncture for Ukraine as it faces Russian aggression, with President Zelenskiy stressing the urgent need for air defence systems and advanced weaponry. Following the bill's signing, the Pentagon unveiled plans to allocate an additional $1 billion in military assistance to Ukraine, encompassing air defence interceptors, artillery rounds, armoured vehicles, and anti-tank weapons. The legislation earmarks $60.8 billion to reinforce Ukraine's defence capabilities, $26.3 billion for Israel and humanitarian aid in conflict zones like Gaza, and $8.1 billion for Taiwan and countries in the Indo-Pacific region to enhance their defenses against China.

On 30 April, the US Senate unanimously approved a bill to prohibit the importation of Russian uranium, part of ongoing efforts to disrupt Russia's trade and financial activities amid its conflict with Ukraine. This legislation, which received unanimous consent in the Senate with no objections, had previously passed in the House of Representatives in December. Uranium serves as fuel for commercial nuclear reactors used in generating electricity. The bill stipulates a ban on these imports 90 days after enactment but includes waivers to address potential supply issues for domestic reactors. Additionally, the legislation allocates $2.7 billion to bolster the domestic uranium processing industry.

Turkey has suspended trade with Israel, citing Israel's alleged role in exacerbating a "humanitarian catastrophe" in Gaza, reflecting escalating tensions between the two nations. The Turkish trade ministry announced a halt to all export and import activities with Israel, until there is a permanent cease-fire in Gaza. This move, following Turkey's previous sanctions on key goods exports in April, is expected to disrupt annual bilateral trade exceeding $7 billion. While described as a temporary pressure tactic, contingent on Israel meeting Ankara's terms, the formal notification to Israel regarding this trade suspension remains unconfirmed. Turkish President Erdoğan has intensified criticisms of Israel, accusing it of "genocide" during its conflict with Hamas and labelling Prime Minister Benjamin Netanyahu as the "butcher of Gaza." Notably, Turkey differs from its Western allies by not designating Hamas as a terrorist group and hosting its leader, Ismail Haniyeh, for discussions in Turkey. Additionally, Turkey announced plans to support South Africa's legal action against Israel at the International Court of Justice.

Commodity: Gold

Gold has been a traditional store of value and a hedge against inflation for centuries, offering investors diversification benefits due to its low correlation with equities and bonds. While it may not match the performance of assets like bitcoin, it also doesn't experience the significant cyclical drawdowns associated with cryptocurrencies. Gold is considered a safe-haven asset, providing protection during economic downturns, financial crises, or geopolitical turmoil. Over the past 50 years, it has shown resilience by delivering positive returns during some of the S&P 500's worst quarterly performances. For instance, in 2022, when the 60/40 equity-bond portfolio faced challenges, gold remained relatively stable with a minimal decline of -0.3%. Since the turn of the century, gold has appreciated significantly, outpacing the total returns of major stock indices like the Nasdaq 100 and S&P 500. While there are periods where gold's performance may lag behind stocks, there are also instances, such as after the Dotcom bubble and during the housing crisis, where gold has outperformed equities, showcasing its role as a defensive asset in diversified portfolios.

Most of the gold mined in 2023 went into making jewellery, with a substantial amount also being sold as a means of storing value, including gold bars or coins. Here's the breakdown of its usage: jewellery accounted for 46% of the usage, followed by 23% used by central banks and institutions, 16% in the form of physical bars, 9% for official coins, medals, and imitation coins, 5% for electrical and electronic purposes, and the remaining 1% for other uses.

In 2023, global gold production exceeded 3,000 tonnes, with China leading as the top producer accounting for over 12% of the total output, followed by Australia and Russia (Figure 2). China's gold mining operations are primarily concentrated in eastern provinces like Shandong, Henan, Fujian, and Liaoning, contributing to the country's estimated 3,000-tonne gold mine reserves as of January 2024, which represent approximately 5% of the global total of 59,000 tonnes. Notably, China also emerged as the largest purchaser of gold for the year, with its central bank alone acquiring 225 tonnes, as reported by the World Gold Council.

Figure 2

China has amassed a substantial stockpile of gold amounting to US$170 billion (£135 billion) following an extensive buying spree, leading to concerns that Beijing may be fortifying its economy in anticipation of potential conflict regarding Taiwan. The People's Bank of China (PBOC) acquired 27 tonnes of gold in the first quarter of the year, pushing its reserves to an all-time high of 2,262 tonnes, as reported by data from the World Gold Council. This accumulation trend has been ongoing since October 2022, representing China's lengthiest period of gold accumulation since at least 2000 and resulting in a 16% increase in its gold reserves over the past 17 months. With gold prices hovering near a historic peak of $2,343 per troy ounce (around 31 grams), Beijing's gold holdings are now valued at $170.4 billion. Experts speculate that China's gold accumulation strategy is likely a preventative measure aimed at safeguarding its economy against potential Western sanctions should tensions escalate over Taiwan.

Climate Change

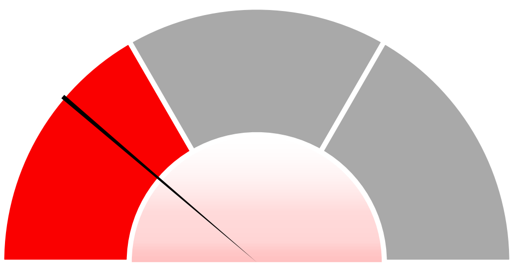
Recent floods have severely affected regions in Russia located just south of the Ural Mountains, approximately 1,200 kilometres east of Moscow. States of emergency have been declared in the Orenburg and Kurgan regions of the Urals, as well as in the Tyumen region in western Siberia, renowned as the world's largest hydrocarbon basin. Flooding originated from the Ural River, which flows from the Ural mountains through Kazakhstan into the Caspian Sea. It breached embankment dams in the city of Orsk on April 5, leading to floods in parts of Orenburg. Notably, some of the flooded areas are significant wheat-producing zones in Russia and Kazakhstan. The Orsk oil refinery in the Urals declared a force majeure on fuel supply from April 8 due to the floods, citing ecological risks and labour safety concerns. The floods have also caused substantial livestock casualties in Kazakhstan, prompting the deployment of a specialised team by the agriculture ministry to manage animal carcasses and mitigate disease spread. Furthermore, flood-related road damages have resulted in hundreds of cargo-laden trucks being stranded in Kazakhstan, as authorities closed affected roads to prevent further risks. We may expect higher wheat prices in the coming months.

Severe flooding also engulfed the UAE in April, triggered by a storm that unleashed the heaviest rainfall in over 75 years, according to government reports. Al Ain, a city bordering Oman, recorded a staggering 254mm of rainfall, surpassing the country's average annual rainfall in a single event. The deluge transformed highways into rivers, leading to abandoned vehicles, and caused significant damage to homes, businesses, and disruptions at one of the world's busiest airports (Dubai International). The death toll stands at twenty reported fatalities, with the recovery anticipated to be sluggish due to inadequate drainage infrastructure in a region accustomed to dry, arid conditions where rainfall is infrequent. Amidst discussions about climate change and the anticipated increase in extreme weather events, there was speculation regarding the role of cloud seeding, a technique that aims to enhance precipitation by introducing chemicals or salt particles into clouds, in exacerbating these catastrophic storms, but there's little evidence that cloud seeding is effective and had it taken place before the storm it may only have had a marginal impact on the total rainfall.

Market Outlook

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

GROWTH ASSETS

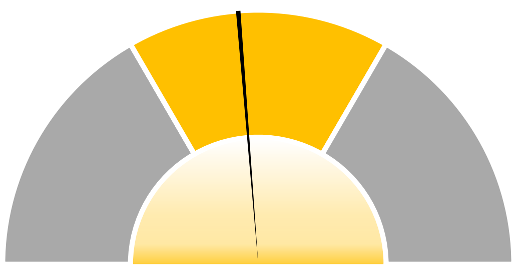


\- **Negative** +

(worse than long-term average returns)

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

INCOME ASSETS



\- **Neutral** +

(similar to long-term average returns)

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