Saturn Advice

markets summary – March 2019

Asset class	Review	Outlook
International equities	All major international sharemarkets rose over the quarter. This was primarily driven by a change in stance by the US Fed with respect to its monetary policy to a more supportive position as well as somewhat easing of global trade tensions.	The US Fed has suggested that the current Fed Funds rate is closer to its 'neutral' position, which may mean no further rate hikes this year. A slower than previously expected rise in interest rates may provide baseline support for equity prices. A positive outcome is likely from ongoing trade negotiations between the US and China. The Brexit deadline has been pushed out to October this year thereby giving more time for a resolution. Volatility is expected to persist, however, this may provide buying opportunities at cheaper prices.
Australasian equities	Australasian equities followed overseas markets higher over the quarter. New Zealand shares performed relatively better than Australian shares due to strong earnings announcements. Australian shares also provided strong returns following the recovery in international equities after the sell off at the end of 2018.	In New Zealand, economic outlook remains positive. However, valuations are relatively high and businesses are struggling to maintain profit margins due to competition and rising costs. The relatively defensive nature and higher dividend yields still provide attraction for investors. The Australian economy is expected to experience modest growth. Risks include potentially lower consumption as a result of lower household net wealth due to falling house prices and potential underperformance of the large financial sector.
International infrastructure	International infrastructure provided strong returns for the quarter benefitting from investor demand for its relatively defensive growth attributes in times of greater volatility.	A change in stance towards more supportive monetary policies by most major central banks is supportive for the defensive growth asset class. Additionally, infrastructure provides an attractive proposition to investors seeking capital preservation in times of higher volatility in wider international equity markets.
Property	Listed property had another strong quarter. New Zealand listed property enjoyed investor demand due to its defensive nature and steady rental yields. Australian listed property outperformed primarily due to investor demand for defensive assets given the volatility in the wider sharemarket.	Both the New Zealand and Australian economies are expected to grow over the medium term. Steady economic growth fundamentally supports the sector. That said, the smaller retail properties in both countries remain vulnerable to e-commerce. Additionally, house construction in Australia continues to struggle due to falling house prices.
International fixed interest	A change in stance towards a supportive monetary policy resulted in decent quarterly returns for investors in this asset class, albeit understandably lower than the recovery in equities.	A slower-than-expected rise in US interest rates, a supportive monetary policy by most major central banks and further sharemarket volatility may support the higher-rated global bonds. That said, the low running yields mean that returns will remain subdued.
New Zealand cash and fixed interest	The RBNZ has kept interest rates on hold. Lower bond yields provided support for bond prices. Corporate bonds outperformed government bonds. The New Zealand dollar held its ground on trade-weighted basis.	Steady or declining interest rates are generally supportive for bond performance. However, low running yields mean subdued returns for bond holders. Higher volatility in sharemarkets may support performance as investors seek capital preservation. The New Zealand dollar is expected to maintain at current levels against most major currencies barring any drastic rise in global tensions.

world and local economies & markets

the market rebounds

Following the worst quarterly performance in years at the end of 2018, equity markets world over produced some of the best quarterly returns since the GFC. The big driver for the turnaround was the US Fed's change of stance in monetary policy from potentially raising interest rates twice in 2019 to holding them for the foreseeable future. While this stance alleviates recessionary concerns for now, there is no denying the slowing growth of the US economy.

The US-China trade concerns are somewhat diminished due to expectations of a positive result from ongoing negotiations between representatives of both sides.

At the time of writing, Brexit has been pushed out to October though its impact is expected to be less material on the global front relative to other factors mentioned above.

Another concern is the slowing Chinese economy. While the Chinese government has reacted to this by implementing a supportive monetary policy, questions remain with respect to the ultimate efficacy of these measures.

Over the quarter, all asset classes produced positive returns. Local and international equities outperformed the defensive assets (local and international fixed interest). Australian REITS and international infrastructure were the best performing asset classes over the quarter while global fixed interest and New Zealand cash provided the lowest returns over this period.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr
New Zealand Cash	0.51	2.01	2.09
New Zealand Fixed Income	2.86	6.99	4.35
Global Fixed Income	2.77	4.63	3.50
New Zealand REITs	8.50	23.95	9.49
Australian REITs	12.65	17.52	2.85
Global Infrastructure	11.92	14.44	8.31
New Zealand Equities	11.73	18.34	13.40
Australian Equities	10.04	9.46	9.12
Global Equities	10.59	10.02	11.35

Returns are shown as %. 3yr return is per annum (annualised). As at 31 March 2019.

international equities

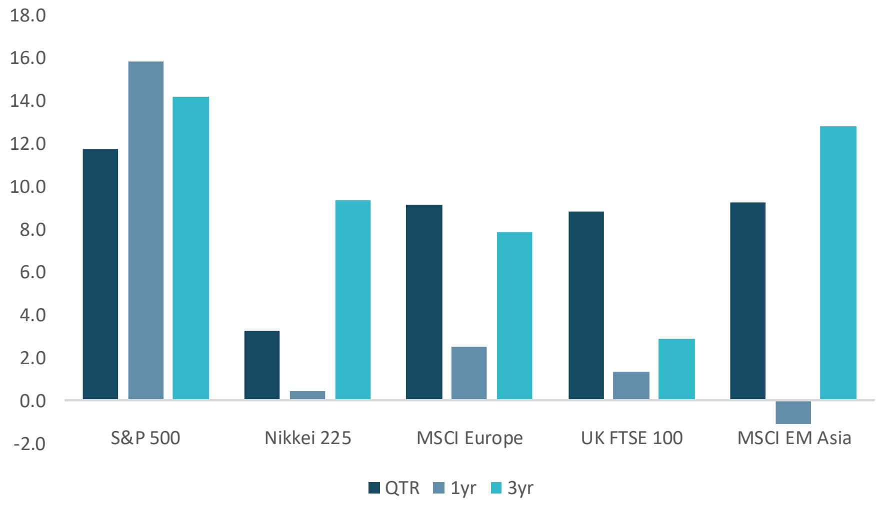
review

As per usual, sentiment in international shares was affected by what happened in the US. The turnaround in the outlook of the US Fed with respect to its monetary policy settled investor concerns over fears of rising interest rates. Furthermore, the progress claimed by both sides at the ongoing US-China trade talks also raised hopes of an agreement, which bodes well for the emerging markets. The Brexit deadline was extended by six months to allow a settlement.

Over the quarter, all major markets rose with the S&P 500 up 11.7%. Outside of the US, the Nikkei 225 was up a modest 3.3% weighed down by slowing global growth given its industrial and manufacturing tilt. The MSCI Europe was up by 9.1% and the FTSE 100 Index was also up for the quarter returning 8.8% primarily due to indications of maintaining a supportive monetary policy by the European Central Bank as well as Bank of England amid Brexit uncertainty.

The emerging markets also enjoyed greater investor appetite due to hopes for an agreement between the US and China. The MSCI EM Asia rose by 9.3% for the quarter.

Regional Indices (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum (annualised). As at 31 March 2019.

outlook

The big sell-off towards the end of last year reflected a variety of interlinked concerns including fears of a recession in the US economy following its long post-GFC expansion, the fallout on individual large economies of a potential trade war between the US and China, the possibility that the US Fed might tighten monetary policy too much or too quickly and the impact of a hard Brexit.

While concerns about a slowdown of the US economy remain, fears of a recession seem to have alleviated for the time being. The primary reason for this is that the US Fed has changed its stance on monetary policy. From indicating 2-3 further hikes in interest rates for 2019, the Fed has indicated that the current interest rates are close to neutral with potentially no further hikes for 2019.

The US coporate profitability has been boosted by the tax cuts offered by the Trump administration. It is expected that profitability may drop back to normal levels going forward. While this drop may paint a negative picture, it should be noted that this drop is from temporarily elevated levels to more sustainable levels.

Representatives from the US and China are claiming to have made progress in trade negotiations. A full blown trade war would be detrimental to US economic growth, and could hurt the incumbent US president's chances at the elections next year. Accordingly, investors expect the Trump administration to reach an agreement on the trade front given the US elections next year.

At the time of writing, the Brexit deadline has been pushed to October 2019 by the EU to provide the UK government time to reach a mutually agreeable solution.

In summary, the case for international equities is not crystal clear. What is clear is that volatility is likely to remain for the short to medium term. Note that volatility provides opportunities to invest in solid businesses with good growth prospects at cheaper prices.

australasian equities

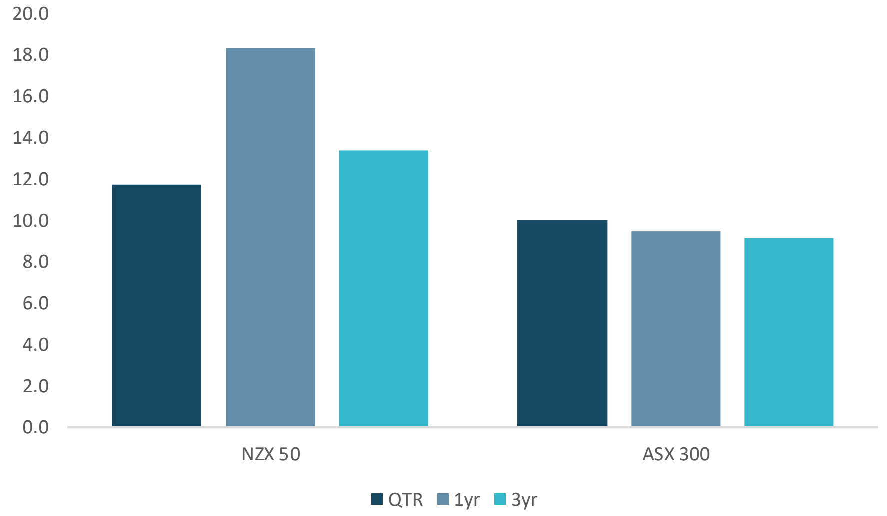
review

The New Zealand share market took its direction from the overseas markets with the S&P/NZX50 Index rising by 11.7% for the quarter. Vista Group (+30.1%), the cinema technology company, was the best performer this quarter on the back of an 8.5% increase in its profits due to strong recurring business. Other strong performers included A2 Milk (+28.3%) and Synlait Milk (+17.8%) on the back of solid earnings announcements.

At the other end, Sky Network Television (-30.2%) was the worst-performing company over the quarter after reporting a 20% fall in its half-year profits due to increased competition from online media platforms. Kathmandu (-18.2%) also fell sharply due to weak summer sales.

Across the Tasman, the Australian share market rose with the S&P/ASX200 Index rising 10.0% over the quarter. This was largely due to hopes of the US and China reaching an agreement given its reliance on the Chinese economy as a key trading partner.

Australasian Equities (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum

outlook

In New Zealand, the economic outlook remains reasonably positive. Both business and consumer confidence has picked up a bit with help from lower petrol prices, supportive fiscal and monetary policies and expectations that monetary policy may become easier yet if the RBNZ becomes concerned about economic growth. In the RBNZ's latest survey of GDP growth expectations, New Zealand GDP is expected to grow by 2.7% over 2019 and 2.5% in 2020.

The big question that remains is how much of this economic growth will translate into corporate profit growth. Businesses have been unable to maintain their margins by increasing prices. Increased competition (both local and overseas) is restricting their ability to raise prices while having to absorb rising input costs particularly due to higher wages. New Zealand share valuations are relatively expensive at 20.9 times future earnings. However, the dividend yields and the relatively defensive nature of the New Zealand market make it particularly attractive in times of greater volatility in international markets.

In Australia, the economic prospects have alternated between faster economic growth and a continuation of the modest economic growth that has prevailed since the winding down of the investment boom of the resources sector. Expectations have tilted towards the latter with the Reserve Bank of Australia forecasting GDP growth of 2.75% for the next two years. One of the risks is the potential impact of lower household net wealth on consumption. Household net wealth has been under pressure due to falling house prices particularly in Melbourne (-8.3%) and Sydney (-9.7%).

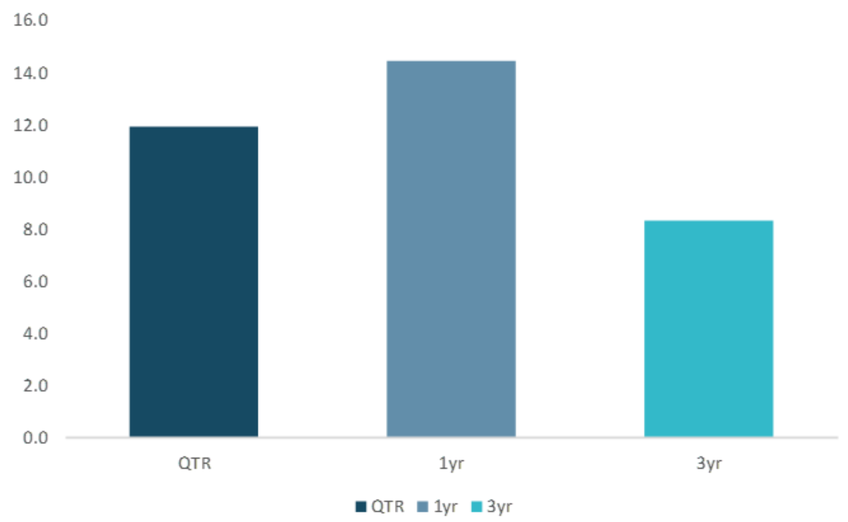
Australian shares in the near term look likely to continue to participate in the global recovery from last year's sell-off. The valuations are reasonable at 15.4 times future earnings, however, the large financial sector may continue to be a drag on performance. Although share prices in this heavyweight sector have already been discounted on the back of negative press, there may be more poor performance to come. Additionally, Australian equities are among the more exposed to any setback to the Chinese economy if the current US-China trade talks fall through.

international infrastructure

review

International infrastructure, a relatively defensive growth asset class, performed well in the March quarter with the S&P Global Infrastructure Index reporting a gain of 11.9% over the quarter.

International Infrastructure (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum

outlook

Investors in international infrastructure were disappointed at the inability of the Trump administration to deliver on its promise of infrastructure spending through 2017 and much of 2018 along with the threat to valuations from rising bond yields.

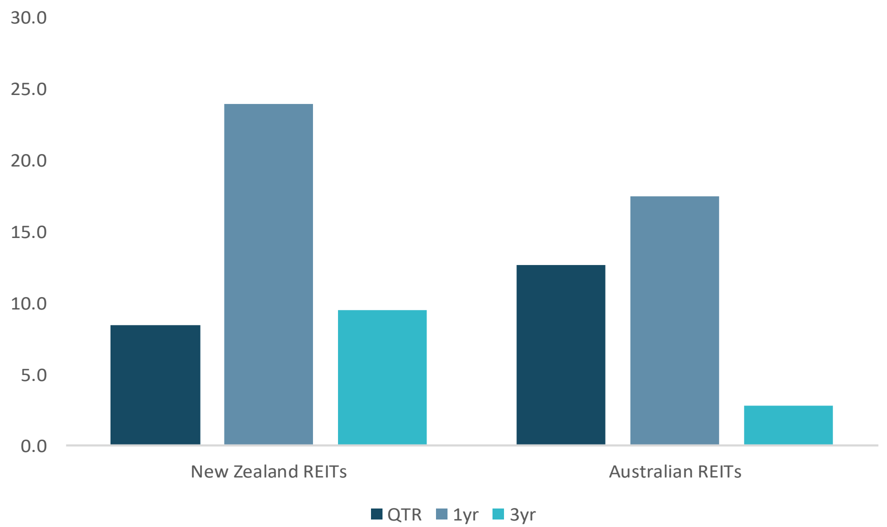
While these negative sentiments still remain, valuations are now looking attractive - even after the strong March quarter – due to updated forecasts indicating bond yields are now likely to rise more slowly and less than previously expected. The more defensive characteristics of international infrastructure relative to other equities is due to the more predictable income associated with this asset class. As a result, international infrastructure is likely to perform better than the wider equity market if negative sentiments were to return.

Property

review

The New Zealand listed property sector provided another strong performance over the quarter with the NZX All Real Estate Index returning 8.5% due to its attractive cash yields.

Australasian listed property (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum

The Australian listed property market outperformed New Zealand. The S&P/ASX300 A-REITs Index recorded a return of 12.7% over the quarter. This was also better than the performance of the wider Australian sharemarket.

outlook

In New Zealand, listed property shares are well placed. The economy is continuing to grow even if capacity constraints are affecting its rate of growth. A growing economy generally supports the drivers of underlying property performance. Colliers' February report showed that office sector remains in high demand. Vacancy rate is at an all-time low of 5.2% in Auckland CBD and Wellington's is at a 10-year low of 6.2% with prime office space almost unavailable (1.2% vacancy). The local retail sector faces the same e-commerce challenges as the rest of the world, but overall business prospects remain solid and the sector could continue to gain particularly in a world where cyclically defensive assets are more in demand.

In Australia, the outlook is not as rosy as New Zealand. While the industrial sector continues to perform well with expectations of rising rents and values, the retail sector is in poor shape with rents and capital values expected to fall across all states. The biggest risk is potentially lower consumer spending due to lower household net wealth. Additionally, e-commerce also adds to the challenges. Against this mixed business backdrop, the recent outperformance by the A-REITs was driven more by investors' defensive mind-set than on the fundamentals of the asset class. In times of greater volatility, A-REITs could continue to do well, but a more realistic view of the operating fundamentals is likely to put a damper on sustained performance.

international fixed interest

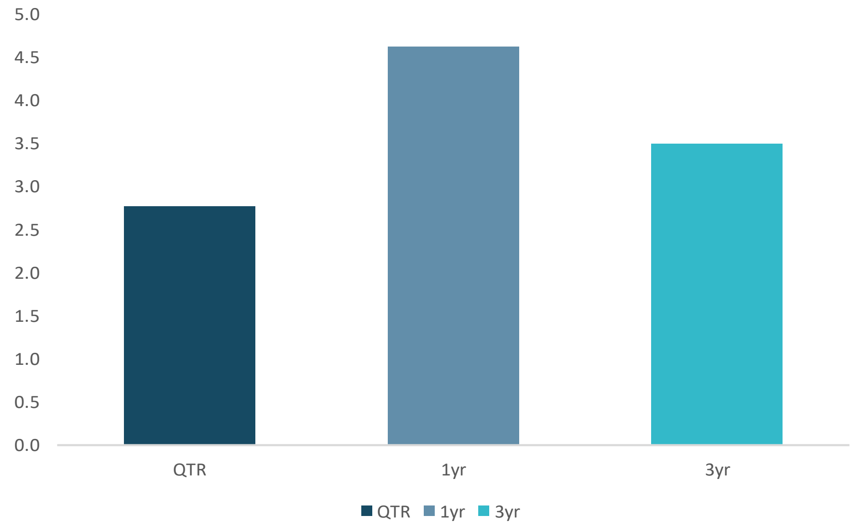
review

There has been very little net movement in government bond yields – bond yields are slightly lower in the US, the Eurozone, Japan and the UK. The result is that the returns from holding government bonds are close to the running (low) yields with little changes in capital values. That said, the US Fed indicated that it may be close to the end of its hiking cycle. This news was supportive for global bond markets and the Barclays Global Aggregate Index provided a total return of 2.8% for the quarter. Given the strong recovery of international equity markets, investors in international bonds missed out in terms of relative performance.

outlook

The change in stance of the US Fed Governor regarding interest rates is indicative of doubts about the outlook for the US economy over the medium term. Rising bond yields are negative for bond values, so a re-think by the US Fed and other major central banks is good news for global bond investors with respect to bond capital values, however, it also means that the very low running yields might continue for even longer.

International Fixed Interest (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum

The outcome of current global tensions may also play a part in performance of the asset class. An agreement between the US and China with respect to trade might not bode well for bonds, whereas, a poor outcome from the negotiations may attract investors due to the capital-preserving role usually played by bonds.

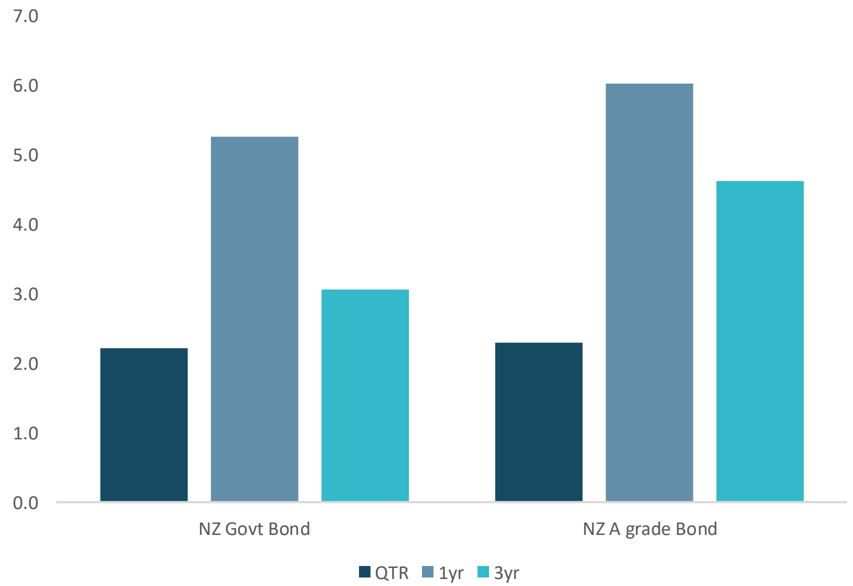
new zealand fixed interest and cash

review

As widely expected, the RBNZ left interest rates unchanged at 1.75%, meaning they have now been on hold since late 2016. However, a new development was the central bank shifting to a 'dovish' stance, which suggests it now expects its next move in interest rates to be lower. This may mean that New Zealand rates have peaked for now despite being at historically low levels. The RBNZ cited weaker global economic growth outlook and slightly weaker domestic spending due to a softer housing market and weak business investment as reasons for its change in view. Accordingly, the New Zealand 10-year government bond yield fell sharply to 1.81%, from 2.37% at the end of 2018. Corporate bonds marginally outperformed government bonds. The New Zealand Government Bond Index rose 2.2% for the quarter while the New Zealand A-grade Corporate Bond Index returned 2.3% for the period.

Despite the RBNZ's change in policy stance, the New Zealand dollar held its ground against a basket of overseas currencies during the quarter on a trade-weighted basis.

New Zealand Fixed Interest (NZD) – Trailing Returns (%)



Returns are shown as %. 3yr return is per annum

outlook

Bonds tend to perform well in an environment of steady or declining interest rates so a change in the RBNZ policy stance might be supportive. However, this also means that the low running yields may continue for the medium-term thereby limiting returns for bond holders. As per usual, heightened volatility in equities may support the asset class performance as investors seek capital preservation.

The New Zealand dollar for the near term is expected to experience little change. However, a very poor outcome from the US-China trade talks might see the New Zealand dollar sold down as investors tend to prefer the US dollar, given its safe-haven status, over commodity currencies in times of heightened volatility.