markets summary – December 2019

Asset class	Review	Outlook
International equities	All major international sharemarkets rose over the quarter. This was primarily due to easing of trade tensions following the US-China ‘phase one’ trade deal and increased certainty regarding Brexit as a result of Boris Johnson’s win in the UK general election.	The outlook remains cautiously optimistic for global equities. While there is support from modest but ongoing global economic growth, risks remain in terms of reignition of trade hostilities between the US and China or emergence of any other geopolitical issues. It is prudent for investors to maintain diversified investment portfolios to limit the impact of negative surprises should they occur.
Australasian equities	New Zealand equities had a positive quarter while Australian equities declined over the same period. Both New Zealand and the Australian share markets produced very strong returns for the year (NZ in particular) partially due to the accommodative policies by their respective central banks.	Both New Zealand and Australian economies are expected to experience modest growth over the medium-term. There may still be support from dividend-oriented buyers. However, valuations in New Zealand are elevated and growth in corporate profitability is needed to support higher share prices going forward.
International infrastructure	International infrastructure had a weak quarter against the backdrop of rising bond yields, however, has provided strong returns over 2019.	International infrastructure continues to look attractive due to the sector providing an income yield better than what is on offer from bank deposits and government bonds. Additionally, infrastructure provides an attractive proposition to investors seeking capital preservation if geopolitical risks were to escalate.
Property	New Zealand listed property had a marginally negative quarter but produced exceptional returns for 2019 due to investor demand for its defensive nature and steady rental yields. Australian listed property also had a negative quarter weighed down by the retail sector, which lagged due to greater competition from e-commerce, and by comparison to New Zealand, had a more modest return for the year.	Operating conditions remain conducive for New Zealand REITs, particularly industrial and commercial property, however, valuations may come under pressure due to rising bond yields. The outlook for Australian REITs is mixed with demand for prime industrial and office properties but a struggling retail sector. Property valuations may get support from even lower bond yields if the RBA cuts interest rates in 2020 as expected.
International fixed interest	Bond yields rose globally during the quarter on the back of improving investor sentiment driven by better-than-expected outcomes for major geopolitical issues. Accordingly, international fixed interest provided a marginally negative return for the quarter. The full year return was good, largely due to falling interest rates for much of the year.	Against the backdrop of an improved economic and geopolitical outlook, central banks will be less inclined to cut interest rates in 2020. This in combination with lower investor demand for portfolio insurance provided by bonds may push bond yields higher, and result in underperformance by the sector. However, investors should bear in mind the role of high quality bonds in reducing portfolio volatility in case the economic outlook worsens or if the geopolitical climate intensifies.
New Zealand cash and fixed interest	The RBNZ maintained interest rates at the all-time low of 1.0%. Money markets expected further easing which resulted in rising bond yields. As a result, the sector had a negative return for the quarter. Corporate bonds marginally outperformed government bonds. The New Zealand dollar fell against most currencies over the year primarily due to more aggressive interest rate cuts by the RBNZ earlier in the year.	The RBNZ is less inclined to cut interest rates further which may limit the upside for bond valuations. Furthermore, low running yields mean subdued returns for bond holders. The New Zealand dollar is expected to hold ground and gradually appreciate against the US dollar barring any drastic rise in global tensions.

world and local economies & markets

soft returns close out an otherwise positive year

Following strong returns for the first three quarters of 2019, the last quarter was negative for most asset classes. October turned out to be positive for all major equity markets as investors continued to look for opportunities following a weak August. However, flat returns in November and weaker returns in December largely unwound the positives from October.

Geopolitics remained at the forefront, a theme that has prevailed throughout most of 2019 and is expected to be a major influence on financial markets through 2020.

The UK held a general election on 12th December, which saw Boris Johnson's Conservative Party win by a clear majority. This essentially means Brexit is going to happen. However, the details of the EU-UK relationship depend on negotiations expected to last all of 2020 and possibly beyond.

On the trade front, the US and China struck a 'phase one' trade deal on 13th December. As part of the deal, the US agreed to scrap planned tariffs on another $156 billion of Chinese imports and halve existing tariffs on $120 billion of Chinese goods. China agreed to buy additional US agricultural products, remove some tariffs on US goods and reform some of its current intellectual property practices.

Despite the abovementioned positive developments, tensions have increased significantly in the Persian Gulf after Iran fired rockets at US military bases in Iraq and shot down a Ukrainian passenger plane.

Whilst most asset classes produced negative returns for the quarter, the full year returns were positive across the board including exceptional returns from the growth assets of equities, listed property and infrastructure.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr
New Zealand Cash	0.30	1.68	1.89
New Zealand Fixed Income	-2.37	5.02	5.06
Global Fixed Income	-0.64	7.48	4.42
New Zealand REITs	-0.62	31.25	17.61
Australian REITs	-5.39	13.30	4.45
Global Infrastructure	-2.50	24.99	11.53
New Zealand Equities	5.18	30.42	18.66
Australian Equities	-2.44	22.83	10.46
Global Equities	0.90	26.89	13.83

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

international equities

review

Geopolitics was the dominant factor impacting investor sentiment. Two of the major geopolitical tensions had investor-friendly outcomes in December. The US and China struck a 'phase one' trade deal, which materially eased the trade tensions. Brexit became a certainty when Boris Johnson's Conservative Party won a clear majority at the UK general election. However, tensions have heightened in the Persian Gulf following attacks by Iran on the US military bases in Iraq.

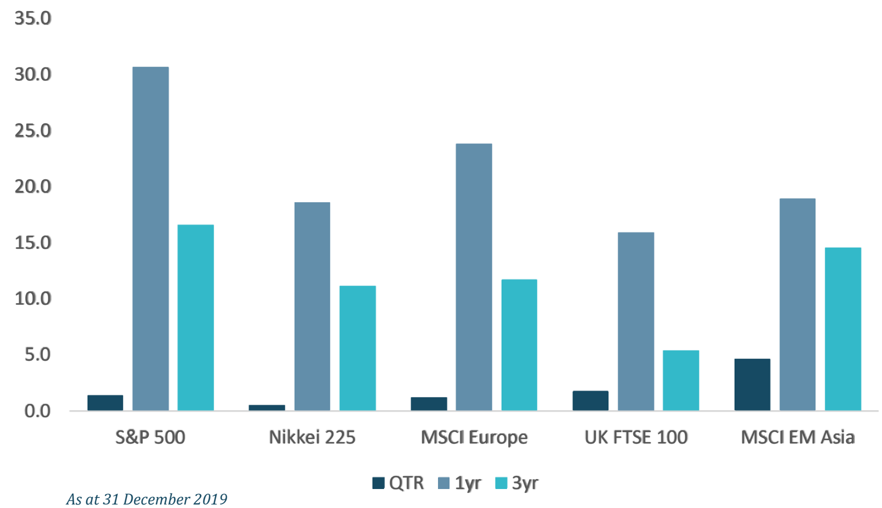
The quarter ended positively for most major sharemarkets against the backdrop of largely progressive geopolitical outcomes.

Over the quarter, the S&P 500 was up 1.4%, the Nikkei 225 was up by 0.5% while the MSCI Europe returned 1.2%. The FTSE 100 Index also rose by 1.7% over the period.

Emerging markets also had a positive quarter with the MSCI EM Asia returning 4.6% for the quarter, mainly buoyed by the easing of trade tensions following the 'phase one' trade deal between the US and China.

It is worth pointing out that among the major sharemarkets, the S&P 500 performed the best for 2019 with a total return of 30.7% for the year.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 December 2019

Saturn Advice
Creating a richer life

outlook

Historically low global interest rates are expected to stay low and have the potential to provide support for global shares given the relative valuations between bonds and shares. Low interest rates is also influencing investor appetite for higher dividend shares, which may result in demand for global shares generally. It is also worth noting the US treasury yield curve has returned to "normal" after being inverted for a significant part of 2019. Historically, an inverted yield curve is considered a harbinger to an economic recession, so the reversion to "normal" is a good omen.

Economic data suggests the immediate outlook for the US economy may be turning for the better. Unemployment is low while wages have picked up along with consumer confidence. These improvements are in stark contrast with the sentiments earlier in 2019 when an inverted US treasury yield curve indicated an oncoming US economic recession. If US growth carries on through 2020 and beyond, it is expected to translate into higher corporate profits providing support for share prices.

While trade tensions have reduced following the 'phase one' trade deal between the US and China, it should be noted that this is only a partial trade deal, which leaves significant issues unaddressed. Therefore, risks remain that trade hositilities may return. Similarly, while the majority win by Boris Johnson's Conservtive Party at the UK general election has made Brexit a certainty, negotiations between the UK and the EU will occupy most of 2020 and beyond to iron out details of the post-Brexit agreement.

Additionally, downside risks to economic growth remain in the form of new geopolitical tensions such as the recent attacks by Iran on the US military bases in Iraq.

All in all, while we maintain a cautiously optimistic short-medium term outlook for global equities, it will be prudent to diversify investment portfolios by including high-quality defensive assets to limit the impact of negative surprises.

australasian equities

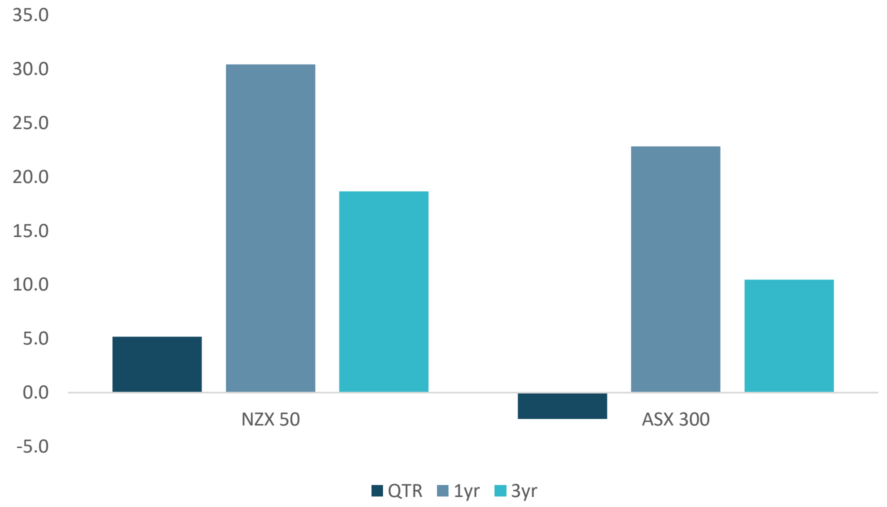
review

The New Zealand share market had another very good quarter with the S&P/NZX50 Index up by 5.2%. This brings the S&P/NZX50 Index total return for 2019 to an exceptional 30.4%. The top two performers for the year were Fisher and Paykel Healthcare (84.9%) and Meridian Energy (+54.8%).

Across the Tasman, the Australian sharemarket underperformed New Zealand with the S&P/ASX300 Index returning -2.4% over the quarter, although the S&P/ASX300 ended the year with a very good 22.8% return for 2019. IT was the best performing sector while the main laggard has been the financial sector.

Both the New Zealand and the Australian sharemarkets have taken support from the interest rate cuts by their respective central banks, which has helped boost valuations.

Australasian Equities (NZD) – Trailing Returns (%)



As at 31 December 2019

outlook

In New Zealand, the economic outlook has improved. Both the ANZ and ASB surveys indicate that business activity as well as business confidence has picked up. The government's Half Year Economic and Fiscal Update (HYEFU) expects NZ GDP growth to increase from 2.2% over 2019/20 to 2.8% over 2020/21 and 2.7% over 2021/22. This growth forecast is driven by expectations of the RBNZ maintaining accommodative monetary conditions in combination with growth in government spending.

The key question is how much of this will flow through to corporate profits. Over recent times, New Zealand companies have faced margin pressures due to online competition, increased price-transparency and an inability to pass increased costs to consumers. However, the HYEFU expects business profits to grow by around 5% in the year to June 2020 and by around 6.5% in the year to June 20201. These growth expectations provide support for share valuations, which remain at elevated levels by historical standards.

In Australia, the economy continues to grow albeit at a slower-than-expected rate. The government's Mid-Year Economic and Fiscal Outlook (MYEFO) lowered its GDP growth forecast for the June 2020 year from 2.75% to 2.25%. Treasury still thinks a pickup in economic growth is around the corner with growth expected to be 2.75% in the year to June 2021. This expectation is further supported by a turnaround in house prices (which previously had been weighed down by poor household confidence and consumer spending) and an improved global economic outlook.

The positive economic outlook is expected to end the drought of profits for Australian corporates. The MYEFO expects corporate profits to grow by 4.75%pa over the next two years.

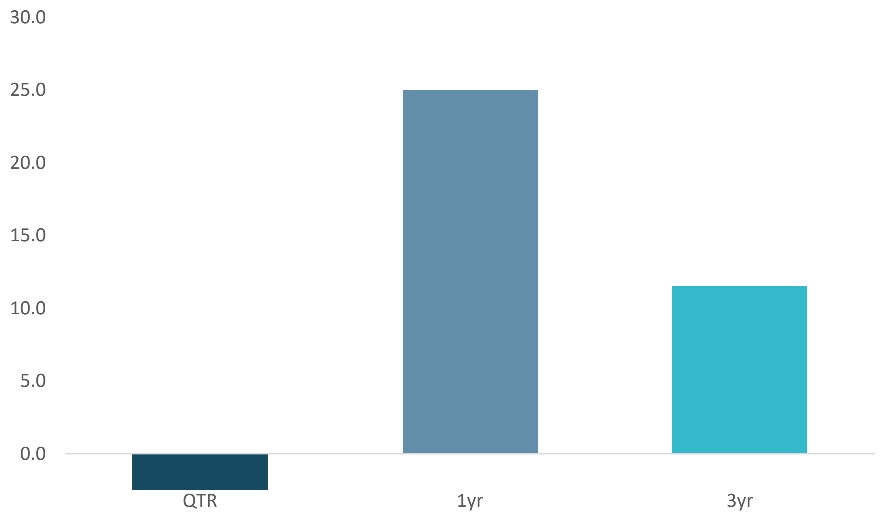
In summary, New Zealand and Australian shares may continue to see support from dividend-oriented buyers with the backdrop of historically low interest rates and a pro-equity sentiment globally. However, investors need to understand that many of the popular Australasian shares are now expensive and investors are paying substantially more for a dollar of corporate earnings than they are for example in the US. The key factor to look at is growth in corporate profitability, which is required to justify the high valuations.

international infrastructure

review

After enjoying investor demand as a relatively defensive growth asset class in times of higher market volatility, international infrastructure took a breather in the last quarter of 2019. The S&P Global Infrastructure Index reported a loss of 2.5% over the quarter against the backdrop of rising bond yields. Despite this, the S&P Global Infrastructure Index provided a very good return of 25.0% for the year.

International Infrastructure (NZD) – Trailing Returns (%)



As at 31 December 2019

outlook

International infrastructure continues to look attractive due to the sector providing an income yield better than what is on offer from bank deposits and government bonds.

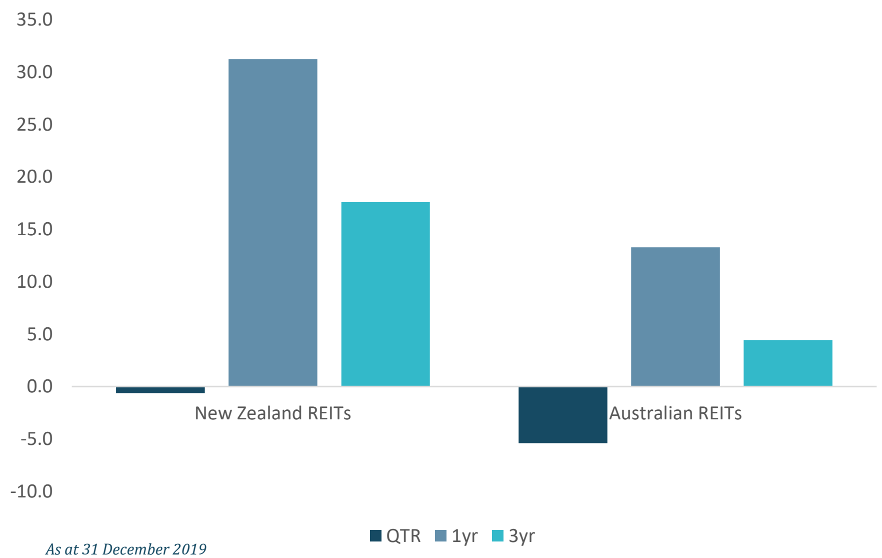
The recent improvement in investor sentiment has somewhat reduced investor demand for the sector. However, as discussed earlier, not all risks have been taken off the table. While infrastructure would not be completely immune to a serious downturn, the sector offers a more defensive exposure to equities particularly the less cyclical subsectors like the utilities due to the predictability of their cash flows. That said, if all indeed does go well in 2020, the more cyclically exposed infrastructure assets (e.g. airports, toll roads) may benefit.

Property

review

The New Zealand listed property sector was marginally negative over the quarter with the NZX All Real Estate Index returning -0.6% over this period. The sector was one of the strongest performers on 2019 with an excellent total return of 31.3% for the year.

Australasian Listed Property (NZD) – Trailing Returns (%)



As at 31 December 2019

The Australian listed property market was one of the worst performing sectors for the quarter with the S&P/ASX300 A-REITs Index recording a return of -5.4% for the period weighed down by the retail sector. While the S&P/ASX300 A-REITs Index returned a healthy 13.3% for 2019, it significantly lagged returns from NZ listed property.

outlook

In New Zealand, the operating conditions remain strong, particularly for industrial and commercial property due to low vacancy and strong investor interest. This is expected to result in a continuation of growth in rental yields for prime properties. The retail sector will be a two-tier market. Flagship shopping centres and easily accessible centralised retail strips are expected to remain popular while others may find conditions testing in the face of increased competition from e-commerce. Although the operating conditions are expected to remain conducive, valuations may be under pressure from rising bond yields from very low levels.

In Australia, the outlook is mixed. Demand for prime industrial as well as office properties is expected to remain robust on the backdrop of high infrastructure spending on new road and rail projects. The retail sector continues to go through a disruptive period with top-end retail holding ground while others finding the conditions very difficult. Support for valuations is expected from even lower bond yields as the Reserve Bank of Australia has indicated intentions of cutting interest rates in 2020.

international fixed interest

review

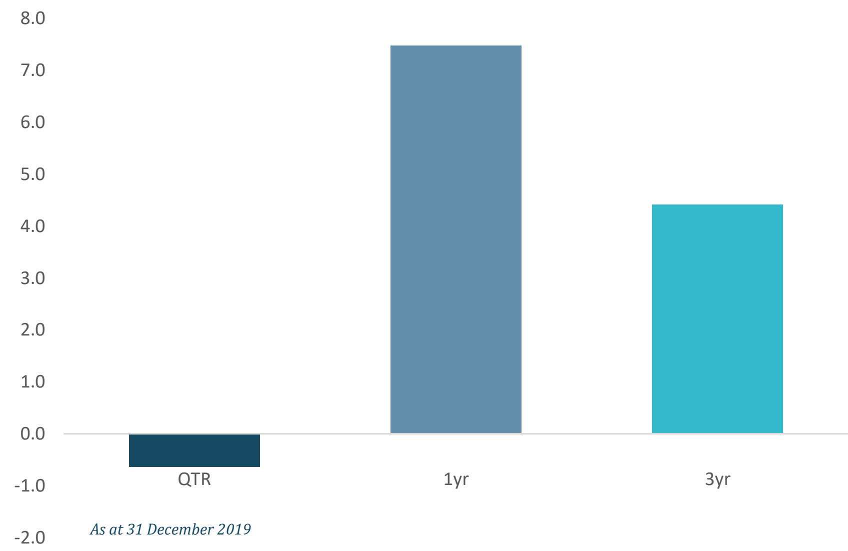
Bond yields in all major global economies rose during the quarter. The US 10-year treasury rate increased from 1.68% to 1.92%. Yields on 10-year government bonds in Germany and Japan, while still in negative territory, recovered to -0.19% and -0.03% respectively. However, the lowest 10-year government bond yield was still that of Switzerland at -0.50% at the end of the quarter. Yields have recovered due to significant improvement in investor sentiment mainly due to relatively positive outcomes on the US-China trade and Brexit fronts. Rising yields are negative for global bond valuations. Accordingly, the Barclays Global Aggregate Index provided a total return of -0.6% for the quarter. The 12 month return was a different story posting a solid 7.5% on the back of falling interest rates over the first 3 quarters of the year.

outlook

Against the backdrop of improving global economic outlook and positive outcomes of the two biggest geopolitical uncertainties i.e. the US-China ‘phase one’ trade deal and the Brexit, central banks are now expected to be less inclined to cut rates further. This outlook has resulted in a recovery in bond yields. Other factors affecting yields include investor appetite for bonds. Again, the improving economic and geopolitical outlook may result in lower investor demand for the portfolio insurance provided by bonds. This can potentially drive the yields even higher, which may result in further underperformance of the sector though lower bond prices.

That said, as mentioned earlier, not all risks have been taken off the table. The US-China ‘phase one’ deal has left many issues unanswered, which can still provoke hostilities from both sides. Additionally, the UK still needs to negotiate the terms of Brexit with the EU.

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



Investors are reminded of the important role bonds plan in a diversified portfolio and that maintaining an exposure to high quality bonds is likely to help reduce volatility of returns should the global economic outlook turn for the worse or if the geopolitical climate intensifies.

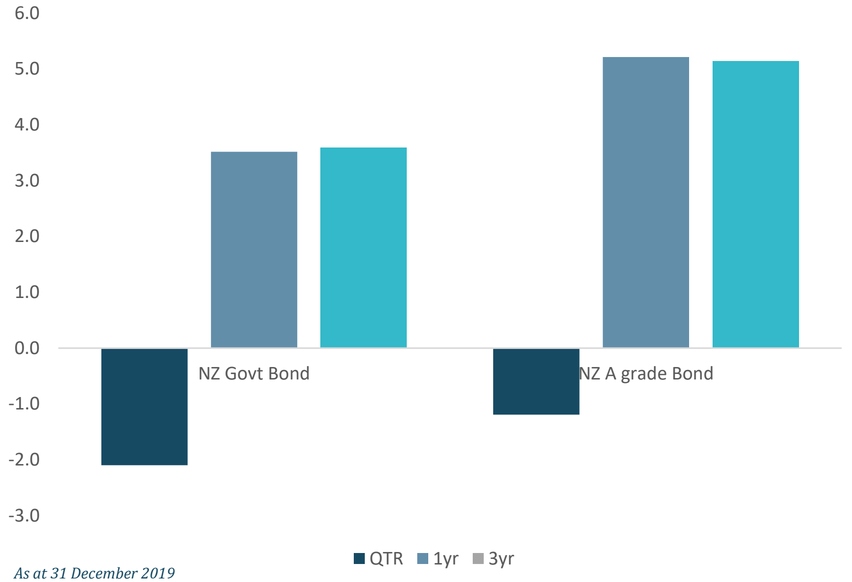
new zealand fixed interest and cash

review

The RBNZ maintained the official cash rate at the all-time low of 1.0%. The RBNZ cited low unemployment and stable inflation as reasons for maintaining the OCR. The money market participants had anticipated a further easing, which did not eventuate. Accordingly, the New Zealand 10-year government bond yield rose sharply to 1.65% by the end of the quarter from 1.1% at the end of the September quarter. An increase in bond yields negatively impacts bond valuations. As a result, the New Zealand fixed interest sector produced a negative return for the quarter. Corporate bonds outperformed government bonds. The New Zealand Government Bond Index returned -2.1% for the quarter while the New Zealand A-grade Corporate Bond Index returned -1.2% for the period.

The New Zealand dollar weakened over 2019 against most major currencies but particularly against the yen and the US dollar due to sharper interest rate cuts by the RBNZ earlier in the year.

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



As at 31 December 2019

outlook

Bonds tend to perform well in an environment of steady or declining interest rates. However, the market expectations regarding the OCR have changed following the unexpected pause by the RBNZ in November and by fiscal policies becoming more supportive of the economy, thereby reducing the need for the RBNZ to lower the interest rates further. This means bond valuations may not have the support they enjoyed in a declining yield environment. With interest rates expected to stay near historical lows for longer albeit with the potential to rise slowly, the resulting lower than "normal" running yields are likely to continue for the medium-term thereby further limiting returns for bond holders.

Having depreciated due to lower domestic rates than the US, the New Zealand dollar is now expected to hold ground and gradually appreciate against a somewhat improving local economic outlook and reduced risk of further easing by the RBNZ.