Saturn Advice
Creating a richer life

markets summary – March 2020

Asset class	Review	Outlook
International equities	All major international sharemarkets declined sharply over the quarter. This was primarily due to the anticipated economic fallout from the COVID-19 outbreak. The governments and central banks have announced various fiscal and monetary policy measures to counter the COVID-19 economic fallout.	The outlook remains uncertain near term. Most global economies are expected to experience a recession. However, the depth and duration of the recession depends on the severity and extent of the COVID-19 outbreak and the efficacy of the counter measures taken by the governments and central banks.
Australasian equities	New Zealand equities followed suit from global share markets and fell sharply for the quarter due to the anticipated economic fallout from the COVID-19 outbreak. Australian equities underperformed New Zealand equities with widespread losses in most sectors.	Business expectations for both New Zealand and Australia indicate a significant slowdown in activity across most sectors. Respective governments have rolled out fiscal support packages with indications for further support. While these support packages may cushion some of the COVID-19 impact, the path to recovery remains uncertain and dependent on the eventual extent and severity of the outbreak.
International infrastructure	International infrastructure underperformed the wider share markets for the quarter against the backdrop of shutdowns caused by the COVID-19 outbreak affecting infrastructure assets, particularly cyclical assets e.g. airports.	The outlook for international infrastructure remains rather challenging in the near term for the more cyclical subsectors such as airports, which will continue to see lower aeronautical revenues until the international travel restrictions are loosened. On the other hand, non-cyclical subsectors such as utilities may hold ground due to the certainty of their cashflows.
Property	Listed property in both New Zealand and Australia was heavily sold down during the quarter. This was driven by investor expectations of revenue losses and tenancy defaults due to the social distancing measures currently in place.	Falling interest rates provide support for property asset valuations while making the property yields look more attractive. Directly affected subsectors including retail and tourism may continue to struggle over the short to medium term. However, offices and even industrials to some extent offer a defensive appeal during the current volatile environment.
International fixed interest	Bond yields dropped across most major economies on the back of deteriorating investor sentiment driven by the economic fallout from the COVID-19 outbreak. Accordingly, international fixed interest provided a positive return for the quarter.	The major central banks have taken extensive measures to support their respective economies as the COVID-19 economic fallout unfolds. Highest quality assets may provide a low return due to investor demand and the quantitative easing measures by the central banks. Concerns exist with respect to debt securities issued by weaker businesses as these may struggle more through the global disruption caused by the outbreak.
New Zealand cash and fixed interest	The RBNZ made an unscheduled cut to the OCR in response to the expected economic fallout from the COVID-19 outbreak. The falling yields helped the asset class provide a positive return for the quarter. The New Zealand dollar fell against the US dollar and the Japanese Yen due to their demand as safe-haven currencies in volatile times.	The RBNZ has likely dropped the OCR as much as operationally practicable for the local financial system. An added stimulus is in the form of a recently announced quantitative easing programme to buy government bonds from investors. This means interest rates will likely stay lower for longer. The New Zealand dollar, being considered a commodity currency may remain out of favour until the outlook for the COVID-19 outbreak turns for the better.

world and local economies & markets

sudden end of the 11-year long bull market

The bull market (refers to a rising share market) finally ended during the first quarter of 2020. The end itself had been anticipated given the duration and magnitude of the bull market. According to FactSet, the S&P 500 index rose over 400% between 9 March 2009 and 19 February 2020. However, no one anticipated the end of the bull market to be driven by a global pandemic in the form of the novel coronavirus (COVID-19). Equity markets the world over were sharply down for the quarter.

At the time of writing, COVID-19 had infected more than a million people across more than 180 countries and territories and had caused more than 70,000 deaths. Sadly, these numbers are expected to be higher by the time the COVID-19 outbreak subsides.

Most governments around the globe have proceeded to implement some form of social distancing measures in a bid to slowdown the spread of COVID-19. While any tangible success of these containment efforts is yet to become apparent, the economic ramifications are beginning to appear. In many countries, entire regions have been locked down, which has caused an instant and often complete loss of near term revenues for businesses in many sectors.

On the plus side, governments and central banks have pulled on a wide range of levers in supportive fiscal and monetary policies to mitigate COVID-19's impact, but the efficacy of these stimulatory policies will depend on the severity of the outbreak and the extent and duration of the social distancing measures.

Over the quarter, all equities asset classes produced negative returns while fixed income benefited from falling yields. New Zealand Fixed Income was the best performing asset class over the quarter while Australian REITs provided the biggest loss for the period.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	0.4	1.6	1.8	2.2
New Zealand Fixed Income	2.8	4.9	5.5	4.9
Global Fixed Income	1.4	6.0	4.6	4.4
New Zealand REITs	-20.4	-3.7	8.5	7.8
Australian REITs	-35.4	-35.0	-10.9	-4.0
Global Infrastructure	-19.6	-10.2	1.3	3.5
New Zealand Equities	-14.8	-0.5	10.8	10.9
Australian Equities	-24.1	-15.3	-2.4	1.7
Global Equities	-10.2	3.1	7.7	8.2

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 31 March 2020.

international equities

review

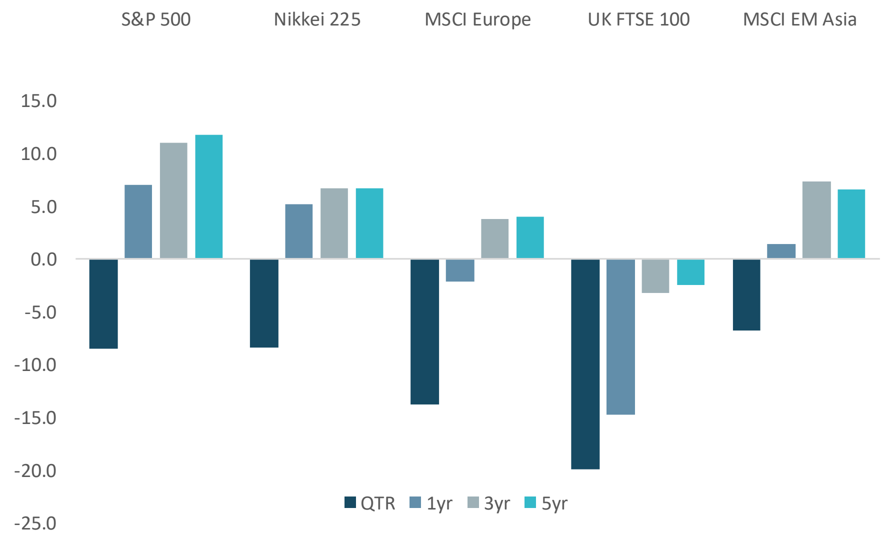
Equity markets world over were strongly positive through January up to mid-February. Thereon, the equity markets fell sharply as the seriousness of the COVID-19 outbreak became more apparent. The equity markets staged a mini comeback towards the end of March largely in response to optimism surrounding stimulatory measures announced by governments and central banks.

Despite the partial recovery, the quarter ended as one of the worst in history for most major sharemarkets.

Over the quarter, the S&P 500 was down 8.5%, the Nikkei 225 dropped by 7.5% while the MSCI Europe declined by 13.8%. The FTSE 100 Index posted a substantial loss for the quarter dropping by 19.9% over the period.

The emerging markets also had a negative quarter albeit better than the developed markets. The MSCI EM Asia declined by 6.8% for the quarter, mainly due to some support from China having successfully contained the COVID-19 outbreak and having made a start towards resuming normal economic activity.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 March 2020

outlook

At the time of writing, the full impact of COVID-19 is still unknown. That said, there are possible scenarios based on how the situation evolves from here on.

The best-case scenario is where the current social distancing measures implemented by governments around the world result in a slowdown of the COVID-19 outbreak through a decrease in the number of daily new cases over the next 4-6 weeks. As a result, social restraints may be loosened to allow for life to begin returning to some sort of normalcy during the second quarter. There would be limited loss to productive capacity and demand will return with rising consumer confidence, buoyed by even lower interest rates. Under this scenario, the global GDP will take a hit for the first half of 2020 but rebound in the second half to manage positive albeit lower GDP growth for the year. Additionally, the pent-up demand may result in a higher global GDP growth in 2021. Note that this will still see most global economies experience a sharp but short recession.

At the other end, the worst-case scenario paints a more challenging picture. This scenario assumes a higher fatality rate and/or a wider outbreak across major economies in the northern hemisphere. This could force the social distancing measures to be further tightened or at least extended for the better part of 2020. Under these circumstances, the economic fallout could see no growth to negative global GDP growth for 2020. There could be numerous business bankruptcies particularly in the directly affected sectors e.g. retail, travel and hospitality. Unemployment could rise to historic highs and business and consumer confidence could drop to historic lows. This scenario could push several global economies into a deep and long recession including the US, euro area and Japan while China may register its slowest GDP growth ever.

We want to reiterate that in these uncertain times, no one can be certain about when the COVID-19 outbreak will peak or the associated economic and financial costs or for that matter the efficacy of the countermeasures taken by the governments and central banks.

All in all, it is important to note that eventually, COVID-19 will run its course and synchronised supportive fiscal and monetary policies by the major governments and central banks will help business and consumer confidence to recover. Additionally, oil-consuming developed economies will benefit from the sharply lower oil prices. Also important to note is that equity markets act in anticipation of future events. Therefore, the recovery in equity markets will occur before the eventual economic recovery, however, the timing remains unclear as yet.

australasian equities

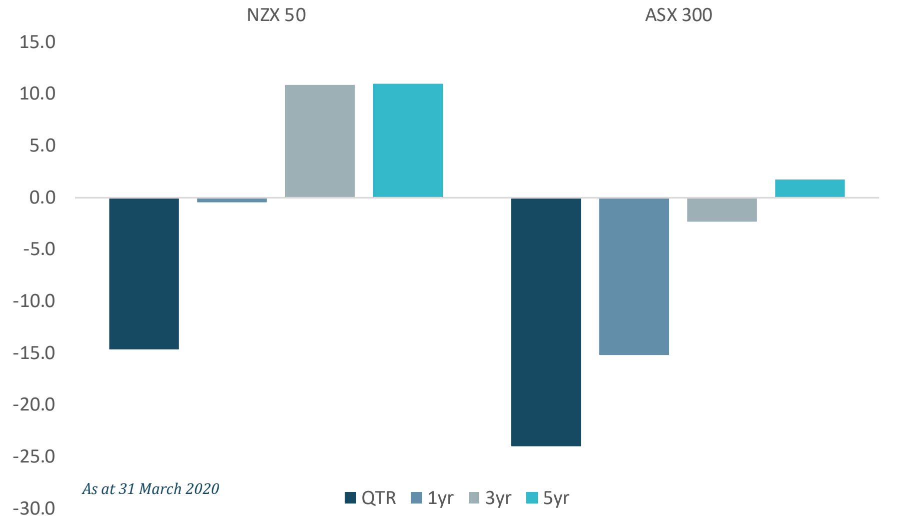
review

The New Zealand share market followed the global share markets lower due to the anticipated impact of COVID-19. The S&P/NZX50 Index declined by 14.8% for the quarter. The worst-hit companies included Air New Zealand (-70.0%) and Tourism Holdings (-68.4%) during this period. Despite the negative sentiments, some businesses had a positive quarter including Fisher and Paykel Healthcare (+36.85%) and A2 Milk (+14.5%).

Across the Tasman, the Australian sharemarket underperformed New Zealand with the S&P/ASX300 Index returning -24.1% over the quarter. The hardest hit sectors included mining, industrials and financials. The only sector that showed resistance was consumer staples, benefiting from supermarkets being stripped of household essentials.

Towards the end of the quarter, both the New Zealand and the Australian sharemarkets took support from the interest rate cuts by their respective central banks, which is supportive for asset valuations.

Australasian Equities (NZD) – Trailing Returns (%)



outlook

In New Zealand, as is the case with rest of the world, the economic outlook looks tough, particularly for the short term. This was reflected in the ANZ business survey which indicated a record number of firms expecting lower business activity for 2020. Forecasts from economists suggest a sharply lower to negative GDP growth for 2020 with an expected recovery towards the end of 2020 and into 2021.

It is important to note that the government has already announced a fiscal support package worth $12.1 billion designed to provide wage subsidies for firms facing significant business downturns, tax support and support for welfare beneficiaries and pensioners among other measures. The government also indicated that the May budget will include the second phase of the overall support package. Despite providing significant support, the government acknowledged that not all jobs or businesses can be safeguarded from the potential downside as a result of COVID-19.

The outlook in Australia is very similar with recent economic surveys indicating business' expectations of significantly lower business activity including contractions in both manufacturing output as well as services business activity. Like New Zealand, the Australian government too announced a significant $17.8 billion fiscal package of wage subsidies, income support for welfare beneficiaries, tax relief and targeted support for sectors under particular pressure.

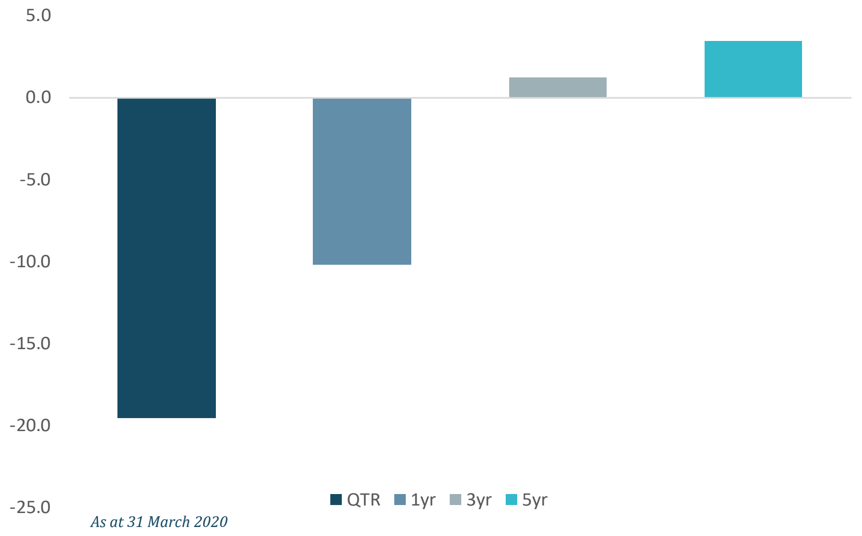
While the fiscal support packages by the New Zealand and Australian governments will help cushion the COVID-19 impact, it remains unclear as to when the outbreak will peak, as that will determine the timing of any significant recovery.

international infrastructure

review

International infrastructure, despite being considered a relatively defensive international equities asset class, underperformed the wider share markets for the quarter. The S&P Global Infrastructure Index reported a loss of 19.6% over the quarter against the backdrop of economic shutdowns caused by the COVID-19 outbreak, particularly the more cyclical assets e.g. airports.

International Infrastructure (NZD) – Trailing Returns (%)



outlook

The outlook for international infrastructure as an asset class looks as unsettled as for other equities. In particular, cyclical assets such as airports will feel the pain from a loss of aeronautical revenues as long as the international travel bans remain in place. Again, this is dependent on the evolution of the COVID-19 outbreak and the impact of the containment efforts. Somewhat unrelated to COVID-19, energy infrastructure assets may also struggle due to the sharply lower oil prices after Saudi Arabia and Russia fell out over output restrictions. While there is hope of an agreement between the two governments, the oil price may remain under pressure from lower demand over the short to medium term due to economic disruptions caused by the outbreak.

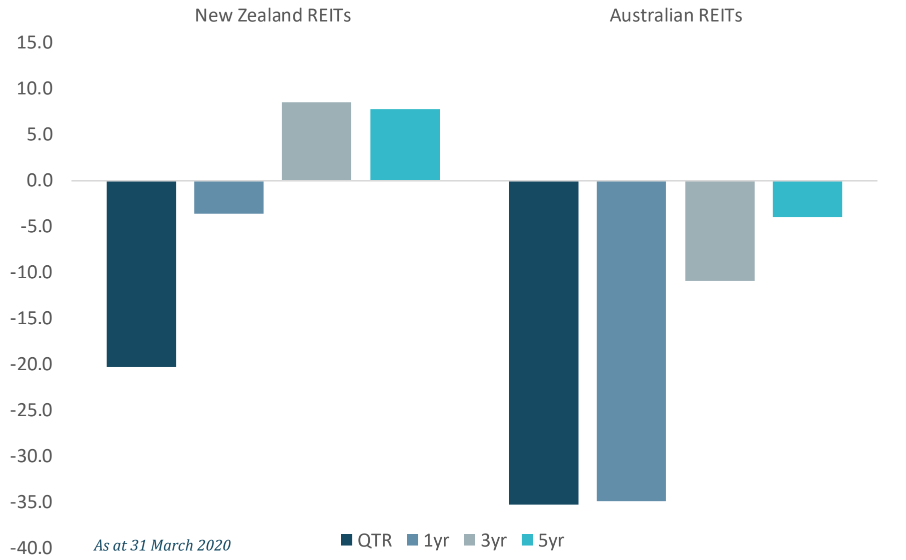
Some bright spots within the asset class are the non-cyclical subsectors such as the utilities which may hold ground due to the certainty of their cashflows.

Property

review

The New Zealand listed property was heavily sold on expectations of defaults by struggling commercial tenants affected by the COVID-19 lockdown. The NZX All Real Estate Index registered a loss of 20.4% over the quarter.

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



The Australian listed property market was the worst performing asset class for the quarter. The S&P/ASX300 A-REITs Index recorded a loss of 34.9% for the period. The worst hit subsector was retail weighed under the expected loss of revenue due to the social distancing measures put in place to limit the COVID-19 outbreak.

outlook

In principle, falling interest rates enhance the asset class' attractiveness. Lower rates provide support to property asset valuations as well as compare less favourably to the higher property yields.

Of course, retail and tourism-oriented subsectors are likely to struggle at least for the short to medium term due to the fallout from the COVID-19 outbreak. However, the relative defensiveness of industrials and office assets (despite issues regarding disruption of supply chain for industrial tenants) may offer some appeal particularly during volatile overall market conditions. That said, there remains high uncertainty over the COVID-19 outbreak and its eventual impact on the affected businesses.

As such, investors may sit on the fence until the peak of the outbreak can be identified or there is more evidence around the effectiveness of the governments' anti-COVID-19 support packages.

international fixed interest

review

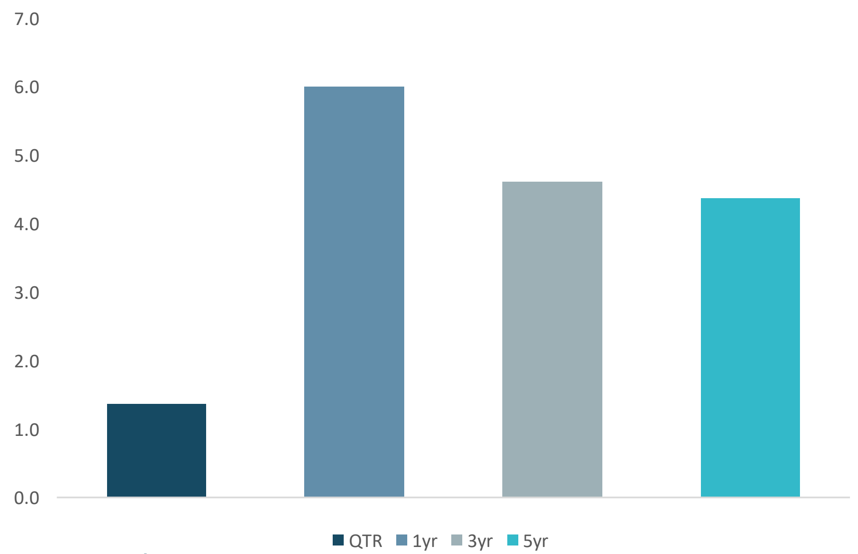
Bond yields in most major developed global economies fell during the quarter. The US 10-year treasury rate decreased from 1.92% to 0.70% during the quarter. This is the first time ever that the US 10-year treasury rate has fallen below 1%. Yield on 10-year German Bunds fell from -0.19% to -0.46% while the yield on the British 10-year Gilt declined from 0.82% to 0.36%. The 10-year treasury rate in Japan marginally increased from -0.03% to 0.02%. The lowest 10-year government bond yield was still that of Switzerland at -0.38% despite recovering late in the quarter. Yields have largely fallen as a result of a significant deterioration of investor sentiment due to the anticipated economic fallout from the COVID-19 outbreak. Falling yields are positive for global bond valuations. Accordingly, the Barclays Global Aggregate Index provided a total return of -1.4% for the quarter.

outlook

Due to already low interest rates, central banks had limited capacity to assist with the economic fallout from the COVID-19 outbreak. Yet, to the extent they could help, central banks eased monetary policies to even more supportive settings. The US Fed has been a clear leader dropping the federal funds rate from a target range of 1.5%-1.75% to 0%-0.25% while also announcing a quantitative easing programme of purchasing at least $500 billion of Treasury bonds and at least $200 billion of mortgage-backed securities. Similarly, the ECB has also committed to quantitative easing, planning to buy EUR 120 billion of securities during the rest of the year on top of its existing purchases of EUR 20 billion a month.

The big picture for the bond markets still revolves around the threat of the COVID-19 outbreak. Returns on the highest-quality assets will likely remain low owing to a

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



As at 31 March 2020

combination of investor demand for capital safety and the central banks' quantitative easing programmes.

At least until the COVID-19 outbreak peaks, conditions will remain difficult for lower-quality bond issuers. Investors are justifiably concerned about the impact of global disruption on the weakest businesses. Some of these businesses may face difficulties in refinancing existing credit facilities.

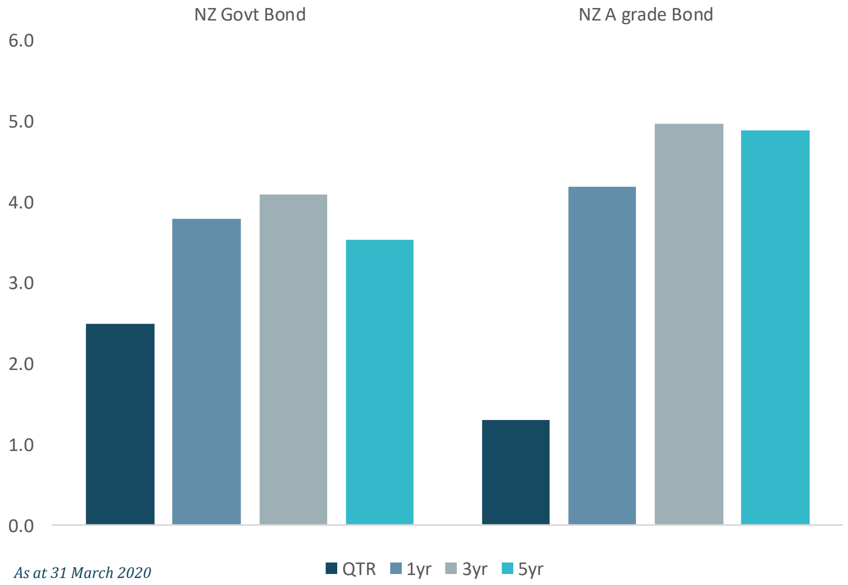
new zealand fixed interest and cash

review

In the face of deteriorating economic conditions globally, central banks of major global economies embarked upon a decisive easing bias. The RBNZ followed suit with an unscheduled official cash rate cut from 1.0% to 0.25%. Accordingly, the New Zealand 10-year government bond yield dropped sharply to 1.06% by the end of the quarter from 1.65% at the start of the year. A decrease in bond yields positively impacts bond valuations. As a result, the New Zealand fixed interest sector provided a positive return for the quarter. Corporate bonds underperformed government bonds. The New Zealand Government Bond Index returned 2.5% for the quarter while the New Zealand A-grade Corporate Bond Index returned 1.3% for the period.

The New Zealand dollar weakened materially against the US dollar and the Japanese Yen despite the US Fed's more aggressive cuts to the official rates. This was driven by

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



As at 31 March 2020

the increased demand for the US dollar and the Japanese Yen due to their status as safe-haven currencies during times of increased volatility.

outlook

At the last OCR cut, the RBNZ cited that the OCR will remain at this level for at least the next 12 months. This suggests that the RBNZ believes that the short-term rates have gone as low as is operationally practicable and that perhaps the local financial system is not operationally ready for lower rates. This could mean negative interest rates are off the table for RBNZ. The RBNZ also delayed the introduction of higher capital reserve requirements for banks, which in effect should help banks extend credit.

The other tool the RBNZ could deploy as part of a supportive monetary policy is quantitative easing whereby the RBNZ can purchase securities from investors. Citing an expectation of a more severe impact on economic activity from the COVID-19 outbreak, the RBNZ has announced a quantitative easing programme whereby it will buy government bonds owned by investors up to the value of $30 billion over the next year.

All in all, these measures are designed to keep the interest rates lower for longer. For term deposit holders, this means that bank deposit rates will go even lower and will stay lower for longer.

The outlook for the New Zealand dollar remains uncertain. Being considered a commodity currency, the local currency is likely to remain out of favour until the COVID-19 outlook were to turn for the better.