Saturn Advice
Creating a richer life

markets summary – June 2020

Asset class	Review	Outlook
International equities	All major international sharemarkets experienced a sharp rebound over the quarter. This was primarily driven by investors buying the March lows and optimism around unprecedented policy support from governments and central banks to counter the COVID-19 economic fallout.	The outlook remains uncertain near term. The markets are expected to experience persistent volatility over the coming months due to a tug-of-war between the economic fundamentals in combination with resurfaced geo-political tensions pulling the markets down and central banks providing a backstop through continued support.
Australasian equities	New Zealand equities followed suit from global share markets and rebounded sharply for the quarter due to comparatively better management of the COVID-19 outbreak. Australian equities outperformed New Zealand equities bouncing off lows from the March quarter.	Relatively better management of the health crisis has presented the New Zealand and Australian economies an opportunity to recover sooner than most developed economies. However, the path to recovery is dependent on avoiding a resurgence of the health crisis and a recovery in consumer confidence.
International infrastructure	International infrastructure underperformed the wider share markets for the quarter against the backdrop of continued shutdowns caused by the COVID-19 outbreak affecting infrastructure assets, particularly cyclical assets e.g. airports.	The outlook for international infrastructure remains mixed with the more cyclical subsectors such as airports expected to continue to see lower aeronautical revenues until the international travel restrictions are loosened. Significant infrastructure spending as promised by governments may result in investing opportunities and higher revenues over the medium term.
Property	New Zealand listed property recovered somewhat over the quarter but is still weighed down by investor expectations of revenue losses and tenancy defaults. Australian listed property was the best performing asset class for the quarter due to a sharp rebound in the retail subsector.	Falling interest rates provide support for property asset valuations while making the property yields look more attractive. Directly affected subsectors including hospitality and tourism may continue to struggle over the short to medium term. Industrials offer a defensive appeal during the current volatile environment due to the accelerated advent of e-commerce.
International fixed interest	Bond yields were flat to lower across most major economies on the back of quantitative easing programmes implemented by respective central banks. 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 see persistently lower yields due to investor demand and the quantitative easing measures by the central banks.
New Zealand cash and fixed interest	The RBNZ maintained the OCR at its historically low level while intensifying its quantitative easing programme. This pushed the yields lower and helped the asset class provide a positive return for the quarter. The New Zealand dollar appreciated against the US dollar due the more aggressive quantitative easing measures by the later and an improvement in investor sentiment supporting commodity currencies.	The RBNZ has indicated that the OCR may be maintained at least till the end of this year. The historically low OCR in combination with the RBNZ's quantitative easing programme to buy government bonds from investors means interest rates will likely stay lower for longer. Term deposit rates may go even lower and stay lower for longer. The New Zealand dollar, being considered a commodity currency may again fall out of favour if the COVID-19 outbreak or the global economic outlook turns for the worse.

world and local economies & markets

the almost too strong rebound

The unprecedented equity markets sell-off in the March quarter has been followed by a near unprecedented rebound during the June quarter. The strength and magnitude of the rebound seemed somewhat a disconnect with the underlying economic and health reality.

At the time of writing, COVID-19 had infected more than 12 million people across more than 180 countries and territories and had caused more than 550,000 deaths. Sadly, these numbers are still expected to be much higher by the time the COVID-19 outbreak subsides.

Governments across the globe implemented social distancing measures to slowdown the spread of COVID-19. While these measures had some success in slowing the number of daily new cases, the economic costs of keeping entire regions locked down and businesses shut began to stack up. Over recent weeks, some governments have been slowly reopening their economies while others have pushed out such plans due to a resurgence of new cases.

As mentioned in our March commentary, governments and central banks pulled on a wide range of levers in supportive fiscal and monetary policies to mitigate COVID-19's economic impact. These measures have been, so far, successful in keeping most businesses alive, many of which were forced to shut often with no or heavily reduced revenues. However, the sustainability of these supportive policies is in question if the outbreak and the accompanying social distancing measures linger for longer.

Over the quarter, all asset classes produced positive returns. After being the worst performer during the March quarter, Australian REITs provided the best return over the June quarter while New Zealand cash provided the lowest return for the period driven by low interest rates dropping even further.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	0.1	1.2	1.7	2.0
New Zealand Fixed Income	2.6	5.7	5.9	5.2
Global Fixed Income	2.4	5.7	5.0	5.2
New Zealand REITs	6.7	-8.3	9.4	9.1
Australian REITs	24.5	-18.8	3.0	3.5
Global Infrastructure	4.6	-11.8	2.5	2.7
New Zealand Equities	16.9	9.0	14.6	14.9
Australian Equities	21.0	-5.4	6.0	4.7
Global Equities	9.9	7.3	11.4	8.0

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 30 June 2020.

international equities

review

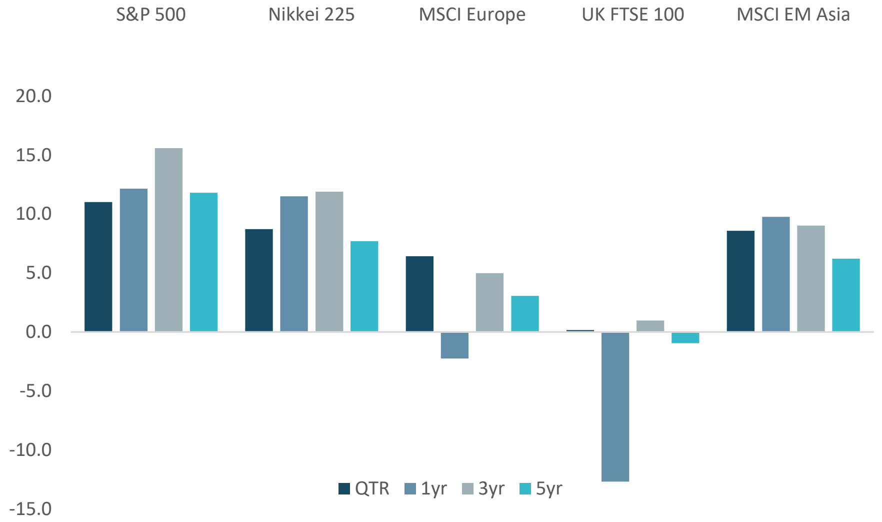
Equity markets world over were strongly positive through April to early June. Thereon, the equity markets gave up some of their gains and moved sideways swayed by the growing concerns surrounding the resurgence of new COVID-19 cases and optimism from policy support announcements by central banks.

Despite the higher volatility towards the end, the quarter ended as one of the best in history for most major sharemarkets.

Over the quarter, in NZD terms, the S&P 500 was up 11.0%, the Nikkei 225 rose by 8.7% while the MSCI Europe returned 6.4%. The FTSE 100 Index underperformed for the quarter returning just 0.2% driven by concerns that the region may experience its worst recession ever.

The emerging markets also had a firmly positive quarter despite some of the Asian countries (e.g. India and Pakistan) witnessing a sharp rise in new cases. The MSCI EM Asia rose by 8.6% for the quarter, mainly due to 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 30 June 2020

outlook

COVID-19 has effectively forced most economies into a recession around the globe. While no two recessions have been similar in the past, most have been either limited geographically or to an economic sector with the larger ones causing ripple effects across other regions and sectors. COVID-19 has been unique at pushing most economies into a recession almost simultaneously and directly affecting most sectors albeit with varying severity. While this may seem scary it is worth noting that most major economies were experiencing GDP growth and businesses among most sectors were enjoying profit growth before being abruptly halted by COVID-19. This means that in theory, GDP and profit growth should return as soon as the health crisis is contained.

In reality though, the path for recovery is not so straightforward. To simplify, there are two sides of the economic equation, the supply side and the demand side. Largely, the supply side is represented by the businesses providing goods and services and the demand side is dependent on consumer spending.

Governments and central banks, using a myriad of supportive policy measures, have done a successful job of mitigating the risk of permanent loss to productive capacity i.e. supply. That said, businesses cannot be sustained through policy support for a prolonged period and need consumer spending to return for sustained survival.

Consumer spending is driven by consumer confidence about their financial future which is significantly affected by the level of unemployment among other factors. COVID-19 has introduced another factor to the mix, being health and safety.

Unemployment levels have seen some improvement over recent weeks. However, there is an argument that survivors amongst businesses include those with inefficiencies or high debt levels which have only been sustained by government support and may not be able to survive once support is withdrawn. Therefore, there is a risk unemployment may rise over the coming months. It can also be argued that consumers may not be keen to return to their normal lives and spending levels whilst elevated numbers of new COVID-19 cases keep making the headlines.

The silver lining may be that with the unprecedented level of investment into developing a successful vaccine for COVID-19, there is a fair chance one may be developed this year. While any such vaccine may not be available to the masses until well into 2021 due to logistical challenges over production and supply, the sheer knowledge that a cure has been found could lead to euphoria and encourage consumers to spend. Additionally, many countries have seen consumer debt levels drop (e.g. repayment of credit card balances) and savings increase over recent months. This suggests that when consumer confidence eventually returns, consumers will have higher than usual capacity to spend which may provide the needed support for businesses and the economies to recover.

In the meantime, we may see persistent volatility in equity markets due to a tug-of-war between the economic fundamentals in combination with re-surfacing geopolitical tensions (US-China, fallout from a no-deal Brexit, China-Australia) pulling the markets down and central banks providing a backstop through continued support.

australasian equities

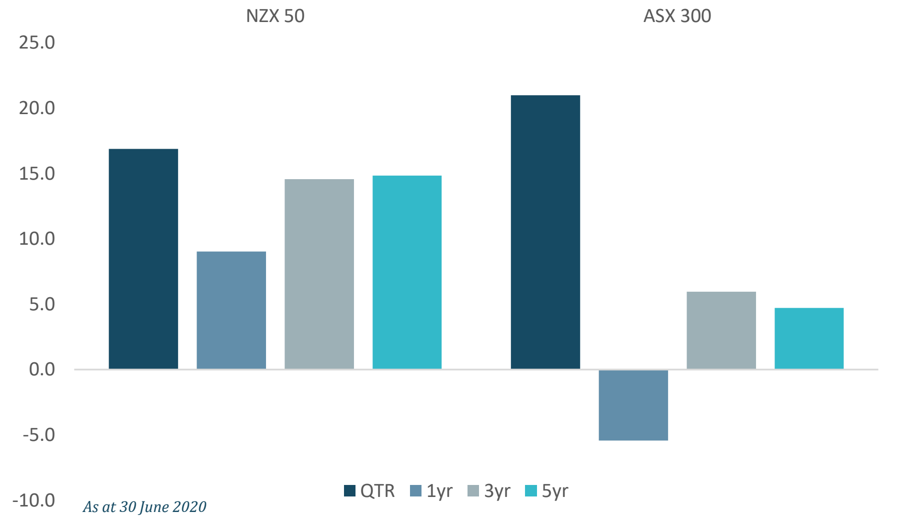
review

The New Zealand share market rebounded strongly from the lows of the March quarter following the COVID-19 sell-off. The S&P/NZX50 Index rose by 16.9% for the quarter. While most companies had a positive quarter, the best performers included Tourism Holdings Ltd (+81.7%) and Air New Zealand (+55.3%) largely due to bouncing off low bases respectively after being among the worst performers in the March quarter. Both benefited from improvement in investor sentiment and expectations that domestic travel may fill some of the void from the loss of international tourism.

Across the Tasman, the Australian sharemarket outperformed New Zealand with the S&P/ASX300 Index returning 21.0% over the quarter. The best performing sectors included those that were hit the hardest in the March quarter. These were mining, industrials and late in the quarter, financials saw a strong rally.

Both the New Zealand and the Australian sharemarkets continue to take support from historically low interest rates and quantitative easing programmes implemented by their respective central banks, which are supportive for asset valuations.

Australasian Equities (NZD) – Trailing Returns (%)



outlook

New Zealand has managed the COVID-19 outbreak very well due to a combination of aggressive social distancing measures and extensive testing and contact tracing. This better than expected outcome is reflected in an earlier than expected rebound in business confidence as reported by ANZ's June Business Confidence Outlook. However, the broader theme remains in line with a typical recession where employment expectations remain firmly negative. While there have been some job losses already, there may be further job losses after the government's wage subsidy scheme expires on 1 September. High job losses could subdue consumer spending which may result in yet more weakness for businesses thereby forcing even more job cuts. That said, a number of other more targeted support schemes are expected to provide some cushioning. There are also concerns about pricing, particularly for the agriculture sector. This is primarily driven by expectations of lower demand for New Zealand's food exports amidst widespread closures of restaurants and bars in key overseas markets. All in all, the New Zealand economy is expected to experience negative GDP growth for 2020 with stronger growth expected in 2021 driven by pent-up demand powering consumer spending.

The outlook in Australia is similar to New Zealand albeit still somewhat dependent on the management of the COVID-19 outbreak. While the country seems to be largely past the outbreak, the state of Victoria has seen a resurgence in new cases over the past few days with Melbourne forced into a lockdown again. The Reserve Bank of Australia expects GDP growth to start recovering in the second half of 2020, led by consumer spending. That said, the economy is expected to experience a recession for the first time in three decades. Unemployment levels are expected to reach historically high levels before dropping closer to pre-COVID levels in two years' time.

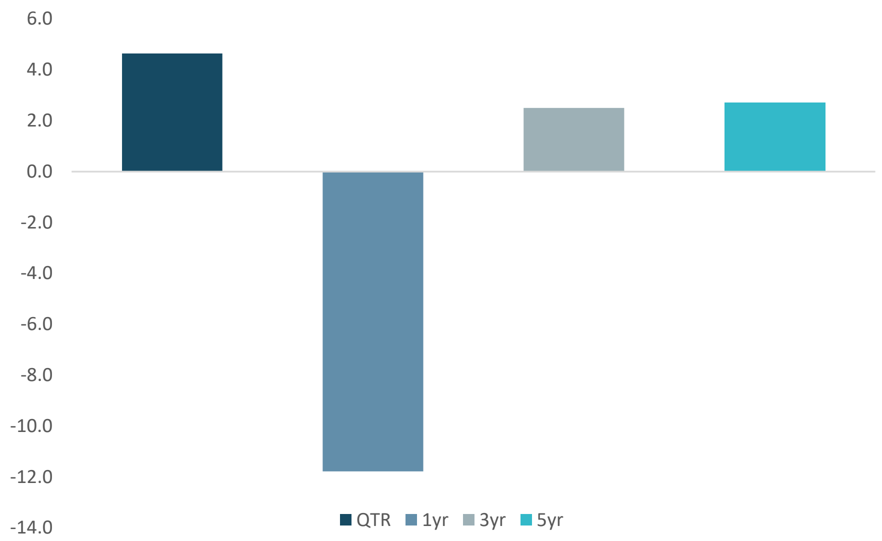
The comparatively better management of the health crisis in New Zealand and Australia has certainly provided the respective economies an opportunity to recover earlier than other developed economies. However, the path to recovery is dependent on avoiding a resurgence of the outbreak and more crucially a sooner than later return of consumer confidence to help businesses resume activity. Cyclical sectors such as consumer discretionary and financials can be expected to benefit in the early part of the economic recovery.

international infrastructure

review

International infrastructure remained out of favour with investors compared to the wider share markets for the quarter. The S&P Global Infrastructure Index reported a return of 4.6% over the quarter against the backdrop of continuing economic shutdowns, particularly for the more cyclical assets e.g. airports.

International Infrastructure (NZD) – Trailing Returns (%)



As at 30 June 2020

outlook

The outlook for international infrastructure as an asset class is mixed. Some cyclical assets such as airports may continue to feel the pain from a loss of aeronautical revenues as long as international travel bans remain in place. Toll roads and bridges are beginning to see some recovery in traffic as countries slowly ease social distancing measures and people prefer driving over public transport until the health crisis is contained.

The OPEC+ reached an agreement on supply cuts to match lower demand in a bid to stabilise the oil price, which briefly turned negative for the first time ever. Although some demand is returning with the economies slowly reopening, the oil price may remain under pressure until the demand fully recovers. This may mean that energy infrastructure assets continue to see lower revenues over the short term.

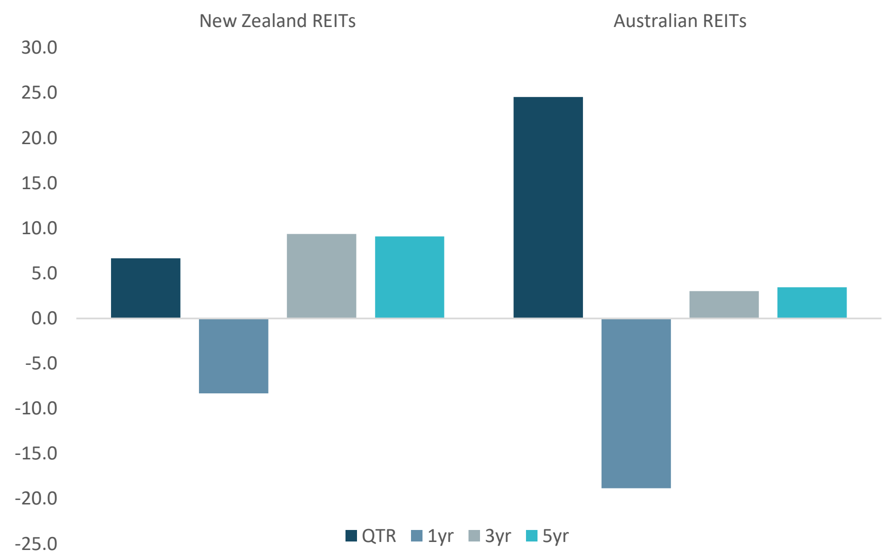
It is worth noting that governments of many developed economies have announced significant infrastructure spending in a bid to create more jobs and help their respective economies recover from the fallout of the outbreak. This may result in new infrastructure assets for investment once complete as well as potentially better revenues from renovated infrastructure assets.

Property

review

The New Zealand listed property recovered some ground while remaining under the cloud of potential defaults by struggling commercial tenants affected by the COVID-19 outbreak. The NZX All Real Estate Index registered a gain of 6.7% over the quarter.

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



As at 30 June 2020

The Australian listed property market was the best performing asset class for the quarter. The S&P/ASX300 A-REITs Index recorded a gain of 24.5% for the period. This was driven by a sharp rebound in the retail subsector following successful containment of the outbreak across most of the country.

outlook

In principle, low interest rates provide support to property asset valuations as well as compare less favourably to the higher property yields.

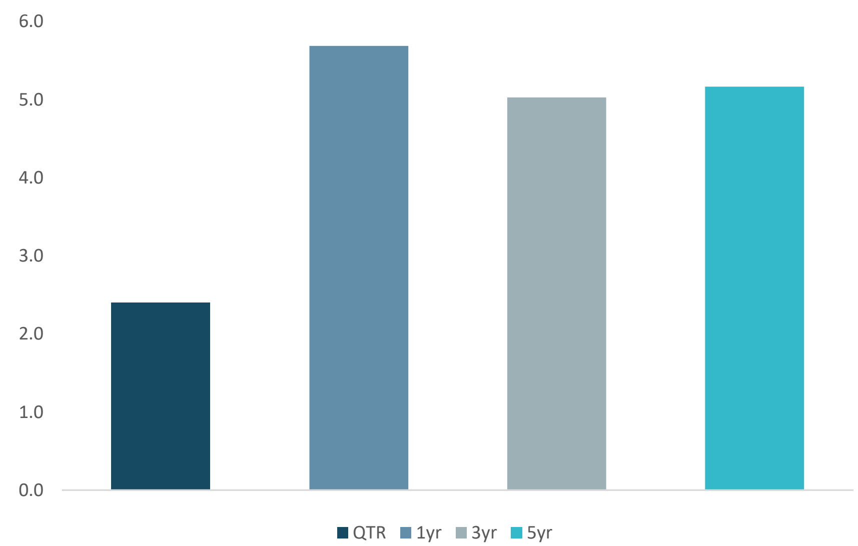
That said, hospitality and tourism-oriented subsectors are likely to continue to struggle until international tourism recovers. While retail is still witnessing markedly lower demand than pre-COVID levels, it has seen some recovery due to the relatively better containment of the outbreak across Australasia. The office space subsector faces a structural headwind with a material part of the workforce preferring to work from home for some of the week versus working full-time at the physical office. This may result in reduced demand for office space as businesses realise they do not need as much space to accommodate their employees. Lastly, the industrial subsector is expected to benefit from greater demand for logistics, partly driven by an accelerated advent of e-commerce.

international fixed interest

review

Bond yields in most major developed global economies were flat to lower during the quarter due to most central banks implementing quantitative easing programmes via purchasing bonds, which theoretically should push yields lower. The US 10-year treasury rate decreased from 0.70% to 0.66% during the quarter while the yield on the 10-year German Bunds, despite some fluctuations during the quarter, remained at -0.46%. This was one of the lowest 10-year yields among the major developed economies. The 10-year treasury rate in Japan marginally increased from 0.03% to 0.04%, however, the yield on the British 10-year Gilt declined from 0.35% to 0.17% as investors preferred the safety of bonds amidst expectations of the worst ever recession for the country as well as ramifications from a no-deal Brexit. Relatively lower yields support bond prices. Accordingly, the Barclays Global Aggregate Index provided a total return of 2.4% for the quarter.

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



As at 30 June 2020

outlook

Having already dropped interest rates to historic lows, central banks have rather limited capacity to assist with the economic fallout from the COVID-19 outbreak through monetary policy manoeuvres. However, as previously mentioned central banks can and many already have implemented quantitative easing programmes of purchasing bonds. The US Fed has further extended its quantitative easing programme to include buying individual corporate bonds, something that it had never done before. This environment is supportive for bond prices.

While the big picture for the bond markets still revolve around the duration and the extent of the COVID-19 outbreak, it is safe to expect that yields will remain low over the medium term due to a combination of investor demand for capital safety and the central banks' quantitative easing programmes.

new zealand fixed interest and cash

review

In the face of challenging economic conditions globally, central banks of major global economies have maintained an easing bias. While the RBNZ did not cut the official cash rate further during the quarter from its historically low level of 0.25%, it intensified its quantitative easing programme to buy government bonds worth up to $60 billion (previously $30 billion) over 12 months. Accordingly, the New Zealand 10-year government bond yield dropped from 1.12% to 0.94% over the quarter. A decrease in bond yields positively impacts bond valuations. Accordingly, the New Zealand Government Bond Index returned 1.6% for the quarter while the New Zealand A-grade Corporate Bond Index returned 3.4% for the period.

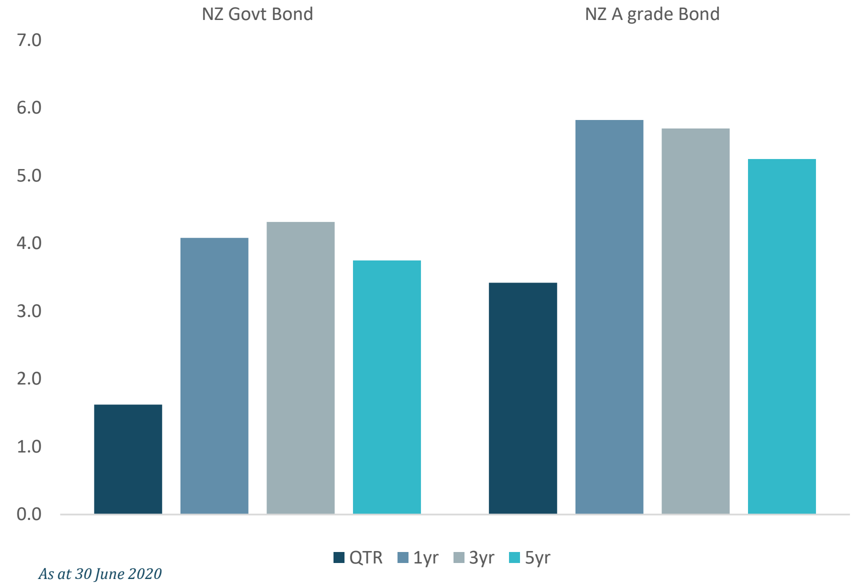
The New Zealand dollar appreciated materially against the US dollar due to the US Fed's more aggressive quantitative easing programme as well as an improvement in investor sentiment from the lows of the March quarter supporting commodity currencies such as the New Zealand dollar.

outlook

At its latest monetary policy review, the RBNZ cited that the OCR will remain at 0.25% at least till year end. While this may suggest that the RBNZ may not cut the OCR further this year, as mentioned the RBNZ is maintaining an easing bias by further intensifying its quantitative easing programme.

All in all, the RBNZ appears determined to keep the interest rates lower for longer to encourage consumer spending, business investment and thereby economic recovery. For term deposit holders, this means that bank deposit rates may go even lower and stay lower for longer.

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



As at 30 June 2020

The outlook for the New Zealand dollar is uncertain. Being considered a commodity currency, the local currency may fall out of favour against the US dollar if the COVID-19 outbreak or the global economic outlook were to get worse.