Saturn Advice
Creating a richer life

markets summary – September 2020

Asset class	Review	Outlook
International equities	Most major international sharemarkets rose over the quarter. This was due to unprecedented policy support from governments and central banks to counter the COVID-19 economic fallout and hopes of a vaccine being developed in the near future.	The outlook remains uncertain near term. Important factors include the evolution of the pandemic, potential development of COVID-19 vaccine(s), continuation of policy support from central banks and governments and the outcome of political events such as the US presidential election and Brexit.
Australasian equities	New Zealand equities followed suit from global share markets and rose for the quarter due to comparatively better management of the COVID-19 outbreak. Australian equities underperformed New Zealand equities due to a significant resurgence of new cases in the state of Victoria.	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 provided a negative return for the quarter underperforming the wider share markets 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 provide investing opportunities and higher revenues over the medium term at discounted prices due to the relative underperformance of the asset class.
Property	New Zealand listed property made a strong recovery over the quarter driven by investor optimism following relatively successful management of the outbreak. Australian listed property also had a strongly positive 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 extensive quantitative easing programmes maintained by respective central banks. Investor preference for equities saw international fixed interest provide a marginally positive return for the quarter.	The major central banks continue to hold an easing bias to support their respective economies. In theory, this environment is supportive for bond prices though further upside in bond prices from here may require a further increase in quantitative easing measures or a significant rise in uncertainty which may drive up investor demand for the safety provided by bonds.
New Zealand cash and fixed interest	The RBNZ maintained the OCR at its historically low level while indicating its 'whatever-it-takes' intentions to facilitate economic recovery. 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 as well as continued improvement in investor sentiment supporting commodity currencies.	The RBNZ has indicated that the OCR may be maintained at least till early next year. The RBNZ has also indicated it remains open to reducing the OCR, potentially to below zero and may also launch a term lending (funding for lending) programme to provide low-cost long-term funding to banks. This could in turn help lower cost of loans to households and businesses. This also means that 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 rebound continues albeit volatility returns

Equity markets continued to march upwards during July and August following a very strong rebound in the June quarter. September saw a return of volatility with most equity markets posting their first negative monthly returns since the sell-off in March this year. Once again, the overall quarterly performance of the equity markets seemed at odds with the underlying economic recovery and the status of the pandemic.

At the time of writing, COVID-19 had infected more than 37 million people across more than 180 countries and territories and had caused more than 1 million deaths. Sadly, these numbers are still expected to be much higher by the time the COVID-19 outbreak is under some control.

During the quarter, many governments started to slowly reopen their economies in the face of rising economic costs of keeping entire regions locked down and businesses shut but had to delay the reopening plans due to a resurgence in new cases in many regions. While complete lockdowns are unlikely to return, the resurgence of new cases may result in extension of some form of social distancing measures for longer than initially hoped for.

The supportive fiscal and monetary policies by the governments and central banks have so far successfully avoided widespread bankruptcies of businesses whose revenues have dried up as a result of the social distancing measures. However, the sustainability of these supportive policies is in question if the intensity of the outbreak and the accompanying social distancing measures were to linger for longer.

Over the quarter, all asset classes except global infrastructure produced positive returns. New Zealand REITs provided the best return over the quarter while global infrastructure was the only asset class to produce a negative return for the period.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	0.1	0.9	1.6	1.9
New Zealand Fixed Income	2.4	5.4	6.4	5.3
Global Fixed Income	0.7	3.9	4.9	4.9
New Zealand REITs	13.3	-4.3	13.9	11.9
Australian REITs	8.9	-15.1	4.1	5.7
Global Infrastructure	-1.3	-19.0	0.7	2.8
New Zealand Equities	2.6	7.5	14.0	16.0
Australian Equities	1.3	-9.2	4.9	7.1
Global Equities	5.1	4.7	11.0	9.7

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

international equities

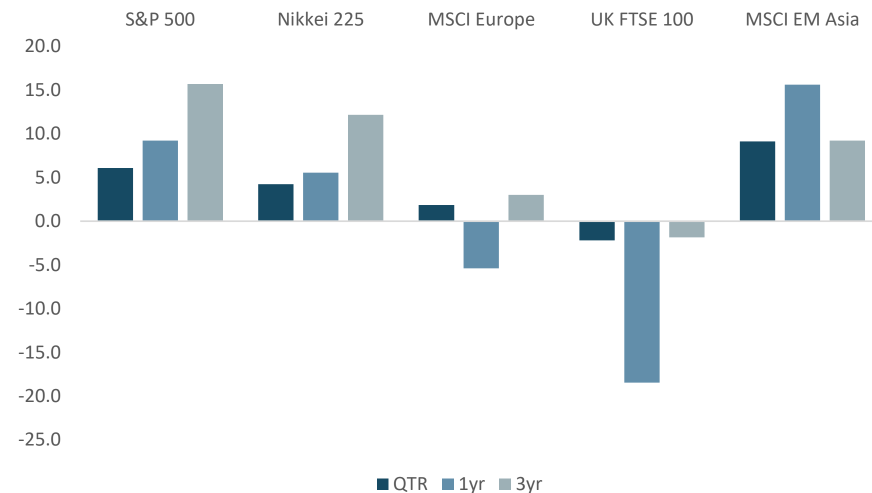
review

Equity markets world over were strongly positive through July and August. During September, most equity markets declined. In the US, almost all sectors declined in September, however, the hardest hit were the best performers of the recent months i.e. the big technology companies. The weakness in the equity markets was primarily driven by fears associated with a resurgence in COVID-19 cases across the US and EU in combination with political uncertainty including the risk of a contested US presidential election and a no-deal Brexit. Despite negative returns in September, the quarter ended firmly positive for most major sharemarkets.

Over the quarter, in NZD terms, the S&P 500 was up 6.1%, the Nikkei 225 rose by 4.2% while the MSCI Europe returned 1.9%. The FTSE 100 Index dropped for the quarter down by 2.2% driven by concerns around a resurgence in new cases, UK’s worst recession ever and the risk of a no-deal Brexit.

The emerging markets outperformed the developed markets. The MSCI EM Asia rose by 9.1% 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 September 2020

outlook

As mentioned in our June markets commentary, COVID-19 has forced most economies into a recession around the globe. For the quarter ended June 2020, the US GDP decreased by 32.9%, the EU GDP declined by 11.9%, Japan saw its GDP fall 27.8% and the UK GDP dropped by 20.4%.

Efforts by many governments to reopen their economies by relaxing social distancing measures have provided some room for economic recovery despite delays caused by a resurgence in new cases.

As explained in our June commentary, 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 rather 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 as such need consumer spending to return for sustained survival.

Consumer spending is driven by consumers' 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 in health safety.

While the unemployment levels have steadied since their sharp rise during the early weeks of the pandemic, they remain at historically elevated levels. Furthermore, there is an argument that current survivors include businesses with inefficiencies or high debt levels which have been sustained by government support and may not be able to survive once the support is withdrawn. Therefore, there is a risk that 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 with a resurgence in the number of new cases making the headlines.

The silver lining remains that with the unprecedented level of monetary and intellectual investment into developing a successful vaccine for COVID-19, there is a fair chance that one or more may be developed this year. At the time of writing, there were 11 vaccines in Phase 3 trials (the last stage of human trials) including 5 with 'approval for limited use' (eg. for military and healthcare workers) pending respective Phase 3 trials results.

While any such vaccine may yet not be available to the masses until well into 2021 due to logistical challenges, the sheer knowledge that a cure has been found may cause euphoria and encourage consumers to unwind pent-up spending desires.

The downside risk to this is a significant worsening of the COVID-19 outbreak forcing social restrictions being implemented for an extended period. Such a scenario may test the extent of policy support from central banks and respective governments. Additional risks are political in nature including the upcoming US presidential election causing a delay in provision of a fiscal stimulus, which as per the US Fed is much needed to ensure the economic recovery remains on track. A clear victory by the Democratic party is likely to result in a fiscal stimulus being passed sooner than if the election was contested.

There's also the risk of a no-deal Brexit as the transition period ends on 31 December 2020 with the negotiators still far from reaching an agreement.

australasian equities

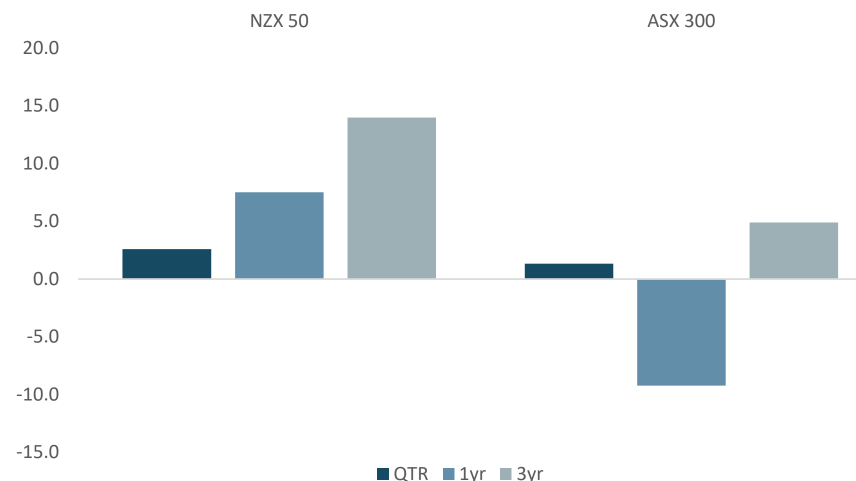
review

The New Zealand share market followed the global developed markets. The S&P/NZX50 Index rose by 2.6% for the quarter. Top performers included Summerset Group Holdings Ltd (+39.2%) and Eroad Ltd (+33.4%) after delivering earnings results higher than markets expectations.

Across the Tasman, the Australian sharemarket also rose but underperformed New Zealand with the S&P/ASX300 Index returning 1.3% over the quarter. The best performing sectors included consumer staples, building materials, gaming and insurance.

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

Australasian Equities (NZD) – Trailing Returns (%)



outlook

New Zealand GDP shrank by 12.2% during the June quarter thereby officially placing the economy into a recession. However, the country has managed the COVID-19 outbreak better than most developed countries 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 September Business Outlook. With limited community transmission of COVID-19, consumers are showing confidence to go out to work and spend as per normal which will provide a much-needed boost to the economy. However, until the New Zealand borders are opened the overall economy will be smaller due to the direct impact on travel and tourism and subsequent impact on retail and hospitality as well as education exports. The recessionary impact on these sectors may result in higher unemployment, weaker business investment and potentially a lower consumer confidence.

The Australian economy also entered its first recession in 28 years following a 7% decline in its GDP during the June quarter. The outlook in Australia is similar to New Zealand albeit still somewhat dependent on the management of the COVID-19 outbreak. While largely the country seemed to be past the outbreak, the state of Victoria saw a material resurgence in new cases forcing an extension in social distancing measures. The Reserve Bank of Australia expects GDP to contract by around 6% for the year to December 2020 but then grow by 5% over calendar year 2021.

For both New Zealand and Australia, the path to recovery is dependent on avoiding a resurgence of the outbreak and more crucially a 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

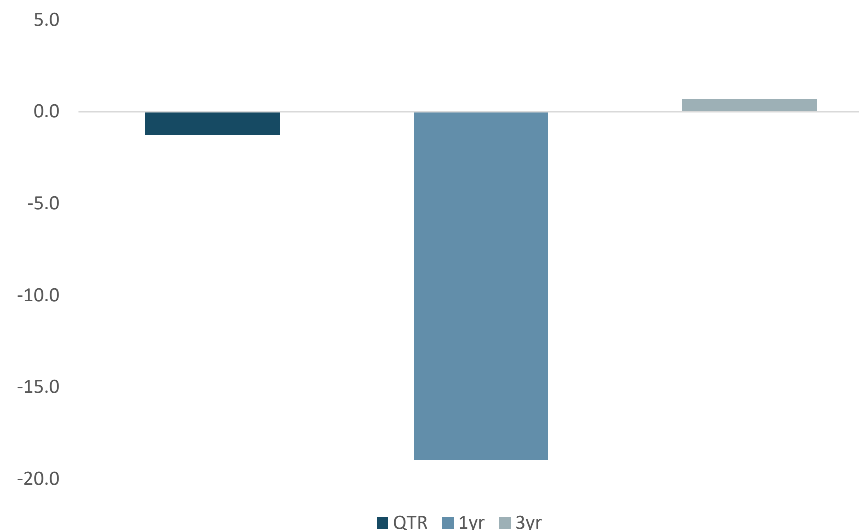
review

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 decline of 1.3% over the quarter against the backdrop of continuing economic shutdowns, particularly for the more cyclical assets e.g. airports.

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 until the international travel restrictions are relaxed. Toll roads and bridges are beginning to see some recovery in traffic as countries strive to stay out of complete lockdowns and people prefer driving over public transport until the health crisis is contained.

International Infrastructure (NZD) – Trailing Returns (%)



Although some demand for oil 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 may continue to see suppressed revenues over the short term.

Governments of many developed economies have initiated significant infrastructure spending in a bid to create more jobs and help the respective economies recover from the fallout of the outbreak. This can result in new infrastructure assets for investment once complete as well as potentially better revenues from renovated infrastructure assets.

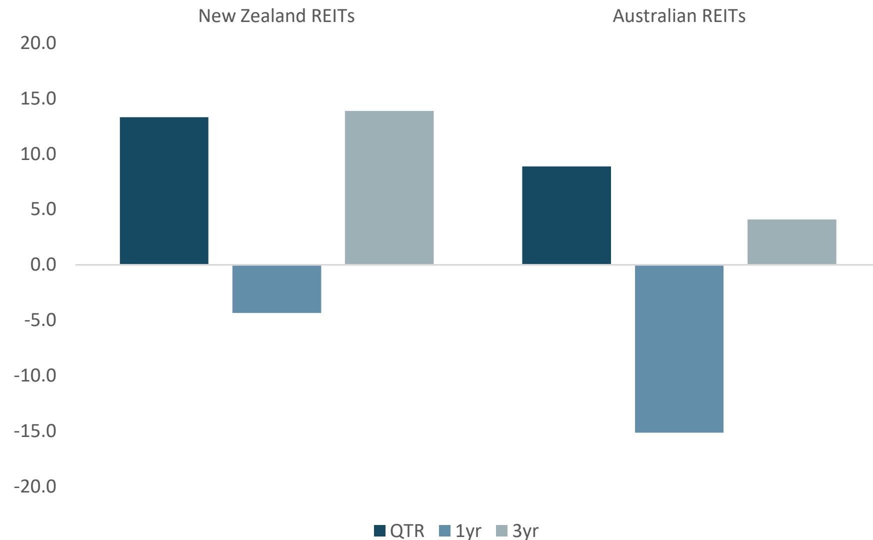
It is worth noting that given the relative underperformance of international infrastructure, investors have a rare opportunity to invest in an income-generating equities asset class at deep discounts.

Property

review

The New Zealand listed property posted solid returns for the quarter buoyed by the reasonably successful management of the outbreak in the country. The NZX All Real Estate Index registered a gain of 13.3% over the quarter.

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



As at 30 September 2020

The Australian listed property market also experienced a strong quarter. The S&P/ASX300 A-REITs Index recorded a gain of 8.9% for the period. This was driven by a sharp rebound in the retail subsector following relatively successful management 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.

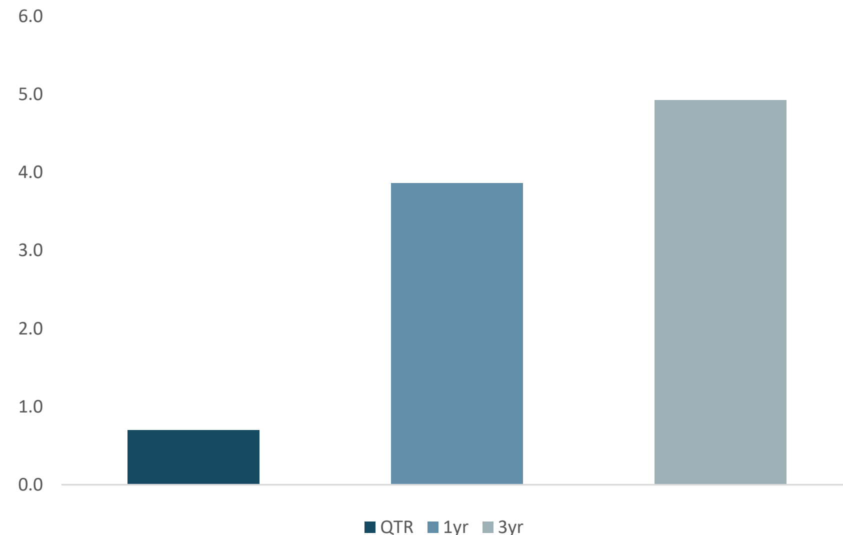
That said, hospitality and tourism-oriented subsectors are likely to continue to struggle until international tourism recovers. While retail is still witnessing markedly lower demand than pre-COVID levels, it has seen some recovery due to the relatively better containment of the outbreak across Australasia. The office space subsector faces a structural headwind with a material part of the workforce preferring a hybrid approach of working from home for part of the week versus working full-time at the physical office. This may result in reduced demand for office space as businesses realise, they may not have all employees at their physical office every day and hence, do not need as much office space. Particularly, this doesn't bode well for new office space that is under development. Lastly, the industrial subsector is expected to benefit from greater demand for warehouses and logistics assets due to 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 maintaining quantitative easing programmes via purchasing bonds, which kept longer duration yields lower. The US 10-year treasury rate marginally increased from 0.66% to 0.68% during the quarter while the yield on the 10-year German Bunds declined from -0.46% to -0.52%. This was one of the lowest 10-year yields among the major developed economies. The 10-year treasury rate in Japan marginally decreased from 0.04% to 0.02% while the yield on the British 10-year Gilt increased from 0.17% to 0.23%. Relatively flat yields at historically low levels saw the Barclays Global Aggregate Index provide a total return of 0.7% for the quarter.

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



As at 30 September 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 have implemented quantitative easing programmes of purchasing bonds. In theory, this environment is supportive for bond prices though further upside in bond prices from here may require a further increase in quantitative easing measures or a significant rise in uncertainty which may drive up investor demand for the safety provided by bonds.

While the big picture for the bond markets still revolves 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 has indicated 'whatever-it-takes' intentions to facilitate economic recovery. Accordingly, the New Zealand 10-year government bond yield dropped from 0.94% to 0.53% over the quarter. A decrease in bond yields positively impacts bond valuations. Accordingly, the New Zealand Government Bond Index returned 1.9% for the quarter while the New Zealand A-grade Corporate Bond Index returned 1.7% for the period.

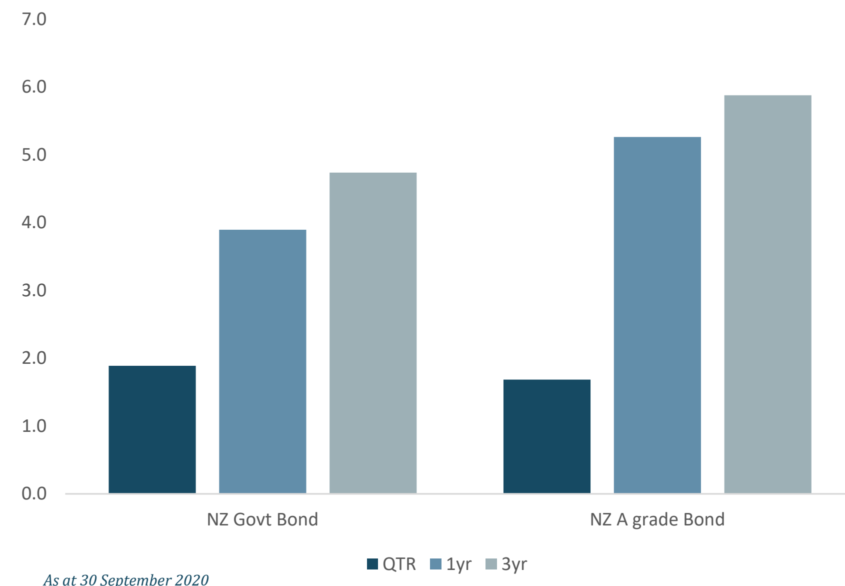
The New Zealand dollar appreciated against the US dollar due to the US Fed's more aggressive quantitative easing programme as well as continued improvement in investor sentiment supporting commodity currencies such as the New Zealand dollar.

outlook

At its latest monetary policy review, the RBNZ cited that the OCR will remain at 0.25% at least till early next year. While this may suggest that the RBNZ may not cut the OCR further this year, as mentioned earlier, the RBNZ is maintaining an easing bias. The RBNZ has also indicated it remains open to reducing the OCR, potentially to below zero and may also launch a term lending (funding for lending) programme to provide low-cost long-term funding to banks. This could in turn help lower cost of loans to households and businesses.

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 (%)



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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.