markets summary – December 2020

Asset class	Review	Outlook
International equities	Most major international sharemarkets rose over the quarter. This was due to successful development of COVID-19 vaccines as well as resolution of political and geopolitical roadblocks including the US presidential election and BREXIT.	The outlook remains uncertain near term. Important factors include the evolution of the pandemic particularly the outbreak of COVID-19 variants, progress of the COVID-19 vaccines rollout, continuation of policy support from central banks and governments. Barring any unexpected negative developments in the above, the world may begin to return to normalcy towards the end of this year.
Australasian equities	Australasian equities followed suit from global share markets and rose for the quarter due to comparatively better management of the COVID-19 outbreak. Australian equities marginally outperformed New Zealand equities.	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 continued support from consumer spending.
International infrastructure	International infrastructure rebounded during the quarter as a result of efforts by many governments across the globe to reopen their respective economies. Infrastructure assets such as toll roads and bridges benefited from increased utilisation during the quarter.	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 continued its strong recovery over the quarter driven by investor optimism following relatively successful management of the outbreak. Australian listed property outperformed New Zealand 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 mixed for the major economies on the back of positive vaccine developments versus resurgence of cases. 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 noting the strong economic recovery following successful management of the outbreak domestically. This resulted in a sharp rebound in yields thereby pushing returns for the asset class into negative territory 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 announced launching of the Funding for Lending Programme to provide low-cost funding to lenders. This may lower cost of loans to households and businesses which in turn could fuel spending and business activity. 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. On the contrary, a better-than-expected vaccines rollout or management of the global outbreak may provide further support for the local currency.

world and local economies & markets

light at the end of a long tunnel?

Equity markets posted another strongly positive quarter albeit with greater volatility than the previous two quarters. Early in the quarter, most major markets declined partially due to a tightly contested US presidential election and a resurgence of COVID-19 cases in many regions of the world. The US equity markets then experienced a very strong upturn with Joe Biden appearing as the winner of the US presidential election stoking expectations of a larger fiscal stimulus. Equity markets in general were also buoyed by multiple COVID-19 vaccine candidates announcing higher-than-expected efficacy rates in their respective last-stage trials. Additionally, the UK and the EU reached a BREXIT deal before the deadline alleviating the associated trade concerns. These positive developments helped equity markets march upwards for the quarter while focusing on the light at the end of a tunnel that still seems to be fairly long.

At the time of writing, the number of registered COVID-19 cases was approaching 100 million people across more than 190 countries and regions while the number of related deaths was over 2 million. 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 had to stall their efforts to reopen their economies in the face of a resurgence in new cases in many regions driven by mutations of COVID-19 deemed to be more contagious than the original strain. This has resulted in an extension and in some regions reinforcement of social restrictions. That said, the biggest vaccination campaign in history has begun with the rollout of COVID-19 vaccines across the globe.

Nevertheless, all asset classes except New Zealand fixed interest produced positive returns for the quarter. Australian equities provided the best return over the quarter while New Zealand fixed interest was the worst performer for the period.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	0.1	0.6	1.4	1.8
New Zealand Fixed Interest	-2.3	5.5	5.0	4.9
International Fixed Interest	0.8	5.4	4.9	4.9
New Zealand REITs	8.5	4.4	14.6	11.8
Australian REITs	11.9	-1.2	4.9	7.6
International Infrastructure	5.4	-12.4	1.3	5.9
New Zealand Equities	11.4	13.9	15.9	15.7
Australian Equities	12.5	4.6	6.0	9.0
International Equities	4.6	8.6	10.1	11.1

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

international equities

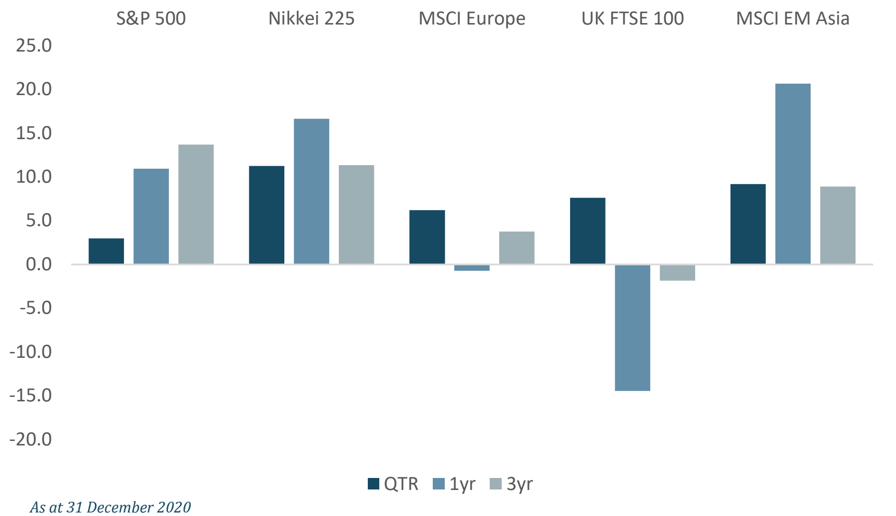
review

As mentioned earlier, equity markets were swayed by political and health developments during the quarter. Joe Biden's victory in the US presidential election saw investor demand for economy-sensitive sectors including financials, energy and small businesses. While this meant that the big technology companies underperformed on a relative basis, most avoided declines during this period. That said, Chinese big technology companies declined after being dealt with unexpectedly stricter anti-trust scrutiny from the Chinese government.

Over the quarter, in NZD terms, the S&P 500 was up 3.0%. The Nikkei 225 and the MSCI Europe outperformed the S&P 500 returning 11.2% and 6.2% respectively because their sharemarkets are heavily weighted towards cyclical or economy-sensitive sectors. The FTSE 100 Index also outperformed returning 7.6% after lagging its peers over the past quarters. Additional support came from the BREXIT deal.

The emerging markets outperformed the developed markets. The MSCI EM Asia rose by 9.2% for the quarter, partly due to support from China having successfully contained the COVID-19 outbreak and displaying good economic activity in combination with the expectation of better trade terms with the incoming Biden Administration.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 December 2020

outlook

Most economies rebounded in the third quarter after being forced into a sharp COVID-19 driven recession earlier in the year. For the quarter ended September 2020, the US GDP increased by 33.4%, the EU GDP expanded by 12.7%, Japan saw its GDP grow 22.9% and the UK GDP grew by 16.0%. Technically, this means these economies are not in recession anymore.

Efforts by many governments to reopen their economies by relaxing social distancing measures have provided some room for economic recovery albeit recent resurgence of cases particularly due to variants of COVID-19 have resulted in reinforcement of social restrictions in some regions which may hurt the economic recovery.

As explained in our previous commentaries, governments and central banks, using a myriad of supportive policy measures, have so far avoided a permanent loss to productive capacity i.e. supply. However, the demand remains well below pre-COVID levels as consumers remain cautious with their spending.

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 introduced another factor to the mix in health safety.

While the unemployment levels have markedly declined from the highs touched during the early weeks of the pandemic, they remain at historically elevated levels. For example, the US unemployment rate has dropped to 6.7% in December 2020 from 14.7% in April 2020 (pre-COVID US unemployment rate was 3.5%). However, there remains 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 is that, at the time of writing two highly efficacious vaccines had already been approved for full use while another eight vaccines were in early or limited use. Not to mention there were an additional 20 vaccines in Phase 3 trials (the last stage of human trials).

While getting the masses vaccinated remains a monumental task due to logistical challenges, there is progress towards the better. At the time of writing, nearly 50 million doses in 51 countries had been administered with the latest rate at roughly 2.5 million doses a day. As the vaccines' rollout reaches full steam this rate is expected to reach much higher levels. It is expected that by the end of the third quarter 2021, a sufficient part of the global population may have some immunity to COVID-19 through a combination of vaccinations and recovery after being infected to allow the world to return to normalcy.

The downside risk to this is the new variants of COVID-19 potentially causing a significant worsening of the outbreak forcing social restrictions being implemented for an extended period – worst case being a repeat of 2020. Another risk is discovery of materially detrimental side-effect(s) associated with one or more of the leading COVID-19 vaccines, which may slowdown the vaccination progress. Such a scenario may test the extent of policy support from central banks and respective governments as debt to GDP ratios continue to rise to unprecedented levels for most economies.

australasian equities

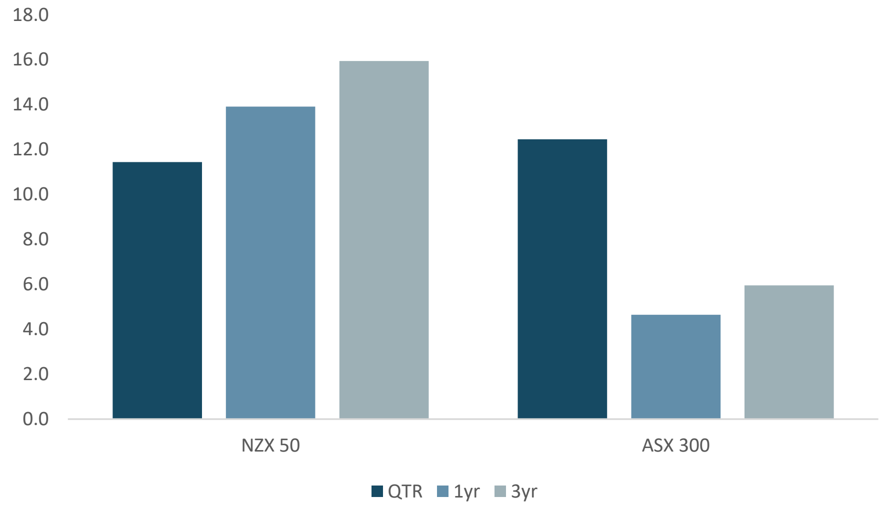
review

The New Zealand share market followed the global developed markets. The S&P/NZX50 Index rose by 11.4% for the quarter. Top performers included Pacific Edge Ltd (+93.7%) and Mainfreight Ltd (+51.0%). Pacific Edge Ltd, a cancer diagnostic company has benefited from the inclusion of its product Cxbladder in a new standard of care in mainstream clinical use while Mainfreight delivered earnings results higher than markets expectations.

Across the Tasman, the Australian sharemarket outperformed New Zealand with the S&P/ASX300 Index returning 12.5% over the quarter. The best performing sectors included building materials, infotech and tourism.

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 (%)



As at 31 December 2020

outlook

New Zealand GDP soared 14.0% during the September quarter bringing the economy out of the recession. The country has managed the COVID-19 outbreak better than most developed countries, which has resulted in a rebound in business confidence as reported by ANZ's December Business Outlook. With no community transmission of COVID-19, consumers are showing confidence to go out to work and spend as per normal. That said, until the New Zealand borders are opened the overall economy will be smaller due to the direct impact on international tourism and subsequent impact on retail and hospitality as well as education exports. Businesses in these sectors continue to reduce costs while putting on hold or cancelling new investment projects. This continues to have a negative impact on household income and thereby spending.

The Australian economy also recovered from its first recession in 28 years following a 3.3% rise in its GDP during the September quarter, benefiting from the easing of lockdown measures as well as supportive fiscal and monetary policies. 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, sporadic hotspots continue to appear requiring targeted lockdowns. An additional risk specific to Australia is the rift with China resulting in the later applying tariffs and restrictions on exports from Australia including wine, coal, timber, red meat and cotton. It is noteworthy that as yet, China has not introduced any restrictions on Australian iron ore, the country's biggest export to China.

For both New Zealand and Australia, the path to recovery is dependent on avoiding a resurgence of the outbreak and more crucially support from consumer spending to help businesses resume activity close to pre-COVID levels. Cyclical sectors such as consumer discretionary and financials can be expected to benefit in the early part of the economic recovery.

international infrastructure

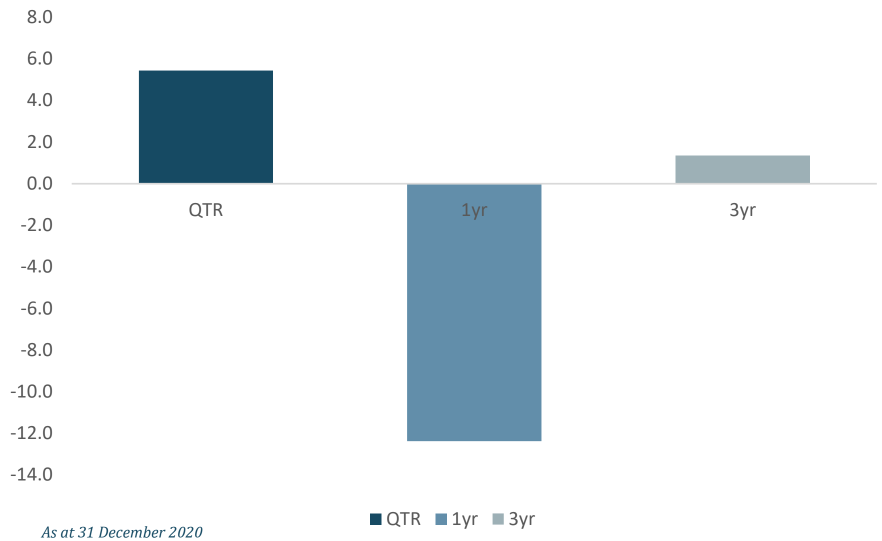
review

International infrastructure rebounded during the quarter. The S&P Global Infrastructure Index returned 5.4% over the quarter helped by some loosening of social restrictions by governments across the globe resulting in revenue generation from utilisation of some infrastructure assets e.g. toll roads, bridges etc.

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, which may happen towards the end of the third quarter if there are no disruptions to the vaccines rollout or a significant outbreak of new variants of the virus. 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 (%)



As at 31 December 2020

Although some demand for oil is returning with the economies slowly recovering, 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.

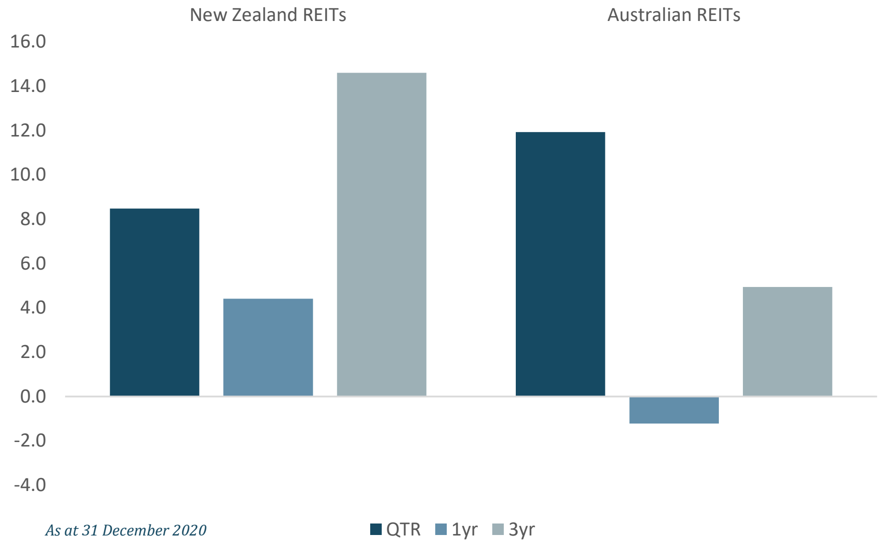
Given the relative underperformance of international infrastructure, patient investors still have a rare opportunity to invest in an income-generating equities asset class at deep discounts.

Property

review

The New Zealand listed property posted another quarter of solid returns buoyed by the successful management of the outbreak in the country. The NZX All Real Estate Index registered a gain of 8.5% over the quarter.

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



As at 31 December 2020

The Australian listed property market outperformed New Zealand with the S&P/ASX300 A-REITs Index recording a gain of 11.9% 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.

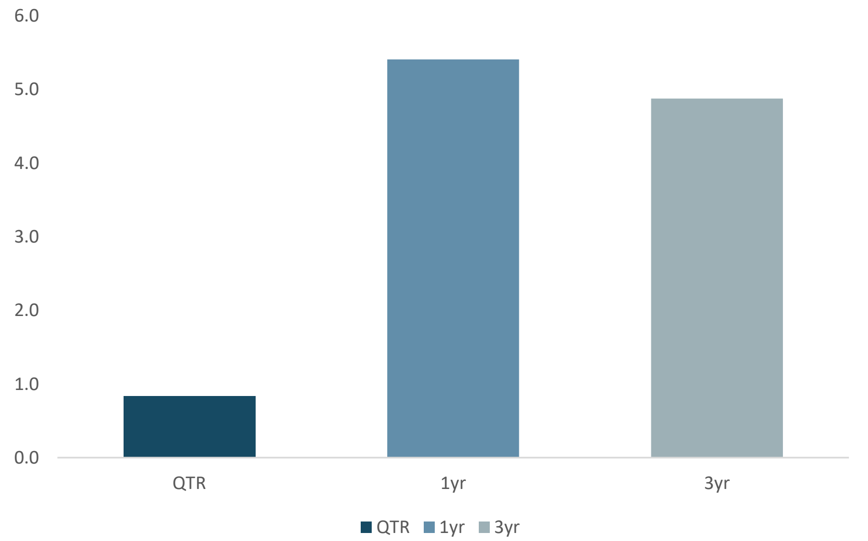
That said, hospitality and tourism-oriented subsectors are likely to continue to struggle until international tourism recovers. While retail is still witnessing somewhat lower demand than pre-COVID levels, it has seen strong recovery due to the relatively better containment of the outbreak across Australasia. 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 across the major developed global economies were mixed during the quarter. The US 10-year treasury rate increased sharply from 0.68% to 0.93% with Joe Biden's victory in the US presidential election fuelling expectations of a larger fiscal stimulus. On the other hand, the yield on the 10-year German Bunds dropped further from -0.52% to -0.58% with a resurgence of cases in the region. This was the lowest 10-year yield among the major developed economies. The 10-year treasury rate in Japan remained flat at 0.02% while the yield on the British 10-year Gilt marginally decreased from 0.23% to 0.20% partly due to an outbreak of virus variants. With mixed movements in yields, the Barclays Global Aggregate Index provided a total return of 0.8% for the quarter.

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



As at 31 December 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

Despite the easing bias by major central banks globally, the RBNZ did not cut the official cash rate further during the quarter from its historically low level of 0.25% as the local economy recovered following successful management of the outbreak. Accordingly, investor preference for equities saw the New Zealand 10-year government bond yield nearly double from 0.53% to 1.02% during the quarter. An increase in bond yields negatively impacts bond valuations. Therefore, the New Zealand Government Bond Index decreased by -2.0% for the quarter while the New Zealand A-grade Corporate Bond Index returned -1.0% for the period.

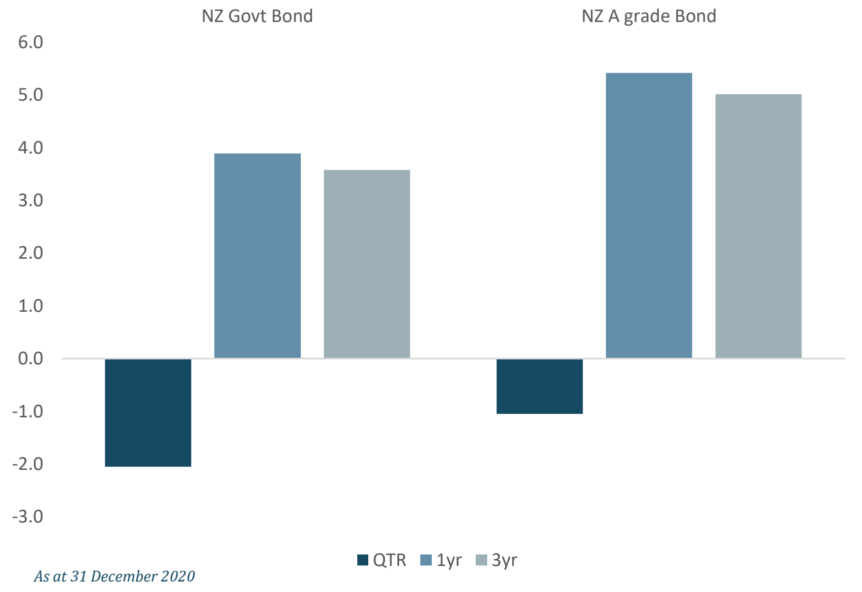
The New Zealand dollar appreciated against the US dollar due to the US Fed's more aggressive quantitative easing programme as well as continued improvement in investor sentiment supporting commodity currencies such as the New Zealand dollar.

outlook

At its latest monetary policy review, the RBNZ announced that it will initiate the Funding for a Lending Programme to provide low-cost funding to eligible participants (lenders), which will reduce retail interest rates further while supporting the supply of credit to the economy. This initiative is aimed at powering business investments and expenditure which may in turn increase household income and spending.

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 (%)



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. On the contrary, the local currency may find further support if the vaccines rollout progresses better than expected and the outbreak gets under control globally.