Saturn Advice
Creating a richer life

markets summary – March 2021

Asset class	Review	Outlook
International equities	Most major international sharemarkets rose over the quarter primarily due to the optimism around economic reopening driven by the progress of the vaccine rollout. Certain sectors experienced volatility due to expectations of an earlier return of inflation and ensuing higher interest rates.	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 normality towards the end of this year.
Australasian equities	New Zealand shares underperformed dragged lower by underperformances of some market heavyweights and also the negative impact of rising bond yields on the dividend paying companies. Australian shares materially outperformed New Zealand driven by financials and infotech.	The outlook for New Zealand is somewhat more uncertain than Australia due to the former's heavier economic reliance on tourism. However, for both countries the path to recovery is dependent on avoiding a resurgence of the health crisis, progress of the respective vaccine rollouts and continued support from consumer spending.
International infrastructure	International infrastructure provided a strong return 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 by governments may provide investing opportunities and higher revenues over the medium term.
Property	New Zealand listed property underperformed over the quarter driven lower by the negative valuation impact of rising bond yields. Australian listed property outperformed New Zealand due to a relatively stronger economic recovery.	Interest rates are still low by historic standards which supports property asset valuations while making the property yields look more attractive. Tourism and related subsectors 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 increased sharply for the major economies on expectations of an earlier return of inflation and thereby higher interest rates. Higher yields are negative for fixed interest asset valuations. Therefore, the asset class underperformed 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. Further rise in bond yields may negatively affect valuations.
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 ensued expectations of an earlier return of inflation pushing yields higher and valuations lower for the quarter. Despite the sharp rise in bond yields, the New Zealand dollar marginally depreciated against the US dollar due to a similarly sharp rise in US bond yields.	The RBNZ has cited commitment to maintaining policy support until the excess capacity in the economy is absorbed resulting in a sustainable return of high employment as well as inflation. This also means that term deposit rates may stay below inflation for the time being. The outlook for the New Zealand dollar depends on the overall outlook for the pandemic and the progress of the economic recovery. Being a commodity currency, New Zealand dollar may see further upside against the US dollar if the global economic recovery progresses without disruption.

world and local economies & markets

a bumpy ride to normality?

Most global sharemarkets posted another strongly positive quarter albeit with a fair bit of volatility. The sharemarkets started the year buoyed by the global vaccine rollout and hope of a return to normality. Then there was speculation that reopening of the global economy may result in a return of inflation followed by rising interest rates. A rise in interest rates is negative for asset prices. Accordingly, sharemarkets fell materially particularly those dominated by growth-oriented sectors e.g. technology. However, sharemarkets recovered following reassurances by central banks that the extraordinary policy support will be maintained (i.e. interest rates will be kept low) until the respective economies are firmly on the growth path. The US government's approval of a US$ 1.9 trillion COVID relief bill provided a boost to investor sentiment in this respect towards the end of the quarter. The US central bank has also cited that it may not consider raising interest rates until very low unemployment and persistently higher-than-target inflation are achieved. Other major central banks are also following similar approaches.

At the time of writing, the number of registered COVID-19 cases was approaching 150 million with over 3 million deaths. On the positive, nearly 1 billion doses of vaccines had been administered with the rate of vaccinations expected to rise as more vaccines are approved for use.

Most governments across the globe are aiming to slowly reopen their respective economies this year as the vaccine roll out progresses. However, these endeavours may get stalled if there are further outbreaks of COVID variants which are not covered by the vaccines being administered.

Returns across asset classes were a mixed bag for the quarter. Fixed income and real estate assets underperformed particularly New Zealand domiciled. The best performing asset class was global shares followed by global infrastructure during the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	0.06	0.33	1.29	1.63
New Zealand Fixed Income	-2.98	-0.42	3.79	3.49
Global Fixed Income	-2.49	1.39	3.99	3.57
New Zealand REITs	-4.20	25.63	14.46	9.69
Australian REITs	0.91	53.14	8.74	5.56
Global Infrastructure	5.69	15.12	5.77	5.61
New Zealand Equities	-4.06	28.21	14.72	13.22
Australian Equities	5.68	45.73	10.55	9.91
Global Equities	7.87	30.39	13.93	13.16

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 31 March 2021.

international equities

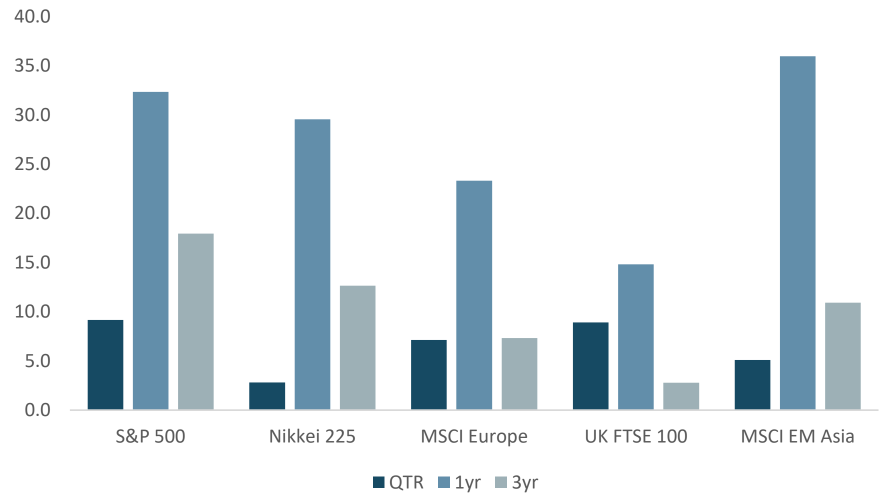
review

As mentioned earlier, equity markets were swayed by optimism around economic reopening driven by the vaccine rollout, expectations of higher interest rates and assurance of continued policy support by governments and central banks. Expectations of higher interest rates particularly affects companies whose value is tied with high growth of future earnings. Accordingly, technology companies as well as companies in the biotech sector saw sharp declines in their share prices relative to companies in mature industries e.g. financials, energy and automobiles. That said, share prices of growth companies recovered late in the quarter following assurances of policy support.

Over the quarter, in NZD terms, the S&P 500 was up 9.2% buoyed by the progress of the domestic vaccine rollout and the decline in COVID related hospitalisations and deaths. The MSCI Europe and the FTSE 100 indices also had strongly positive quarters returning 7.1% and 8.9% respectively. This was driven by economic reopening optimism with progress on their respective vaccine rollouts, which may support the regions heavy-weight cyclical sectors such as energy, automobiles and financials. The Nikkei 225 underperformed on a relative basis with a return of 2.8% for the quarter.

The emerging markets also relatively underperformed the developed markets. The MSCI EM Asia rose by 5.1% for the quarter, somewhat held back by the Chinese government's regulatory crackdown on the Chinese technology companies.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 March 2021

outlook

Most economies continued to rebound in the fourth quarter of 2020 after being forced into a sharp COVID-19 driven recession earlier in the year. However, for the year ended December 2020, many developed global economies shrank by historic levels to reflect the impact of COVID. For the full year 2020, the US GDP decreased by 3.5% (the largest annual decline in 74 years), the EU GDP shrank by 6.2%, Japan saw its GDP shrink 4.8% and the UK GDP contracted by 9.9% (the largest annual fall in UK GDP on record).

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 slow 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 continue to be cautious with their spending.

That said, the extraordinary policy support has seen significant expansion of household balance sheets. In simpler terms, credit card and personal debt levels have gone down while savings have increased. This indicates pent-up consumer capacity to spend as the world moves past COVID. This capacity to spend has the potential to provide significant support to economic growth from the demand side.

At the same time policy support has had a similar impact on corporate balance sheets. Aggressive corporate bond (debt) buying by central banks has resulted in a decrease in debt levels and expansion of cash on corporate balance sheets. Accordingly, companies have increased capacity to invest in resources (e.g. hire new staff) or invest in new projects as demand recovers.

There is optimism on the health front too. At the time of writing, eight vaccines had already been approved for full use while another five vaccines were in early or limited use. Not to mention there were an additional 23 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 1 billion doses in 155 countries had been administered with the latest rate at roughly 17 million doses a day. As the vaccines' rollout reaches full steam this rate is expected to increase. Some regions are well ahead in the progress of their vaccine rollouts and consequently may be able to return to normality over the coming months. However, given the interconnected nature of the global economy, the economic recovery may require the world as a whole returning to some normality.

Further 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. However, this worst case scenario will likely be limited to an outbreak of a variant materially resistant to vaccines and/or with a materially higher mortality rate. 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. Either of these scenarios 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

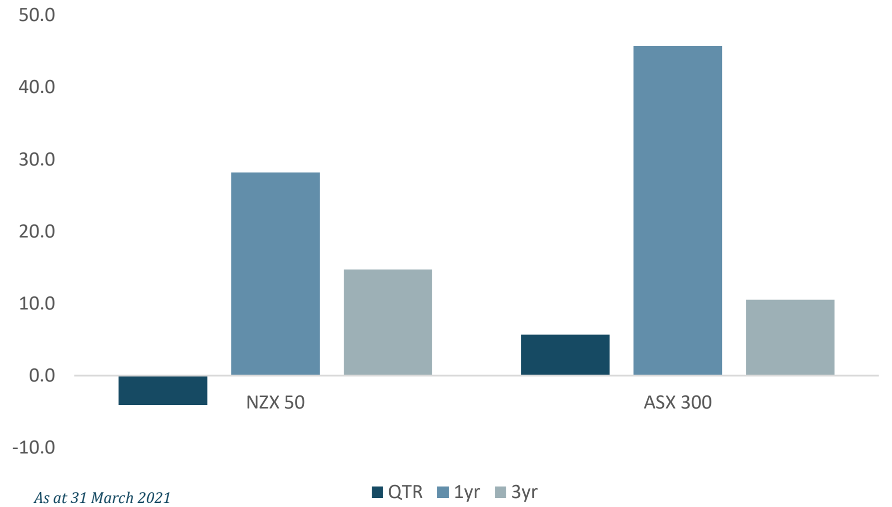
review

The New Zealand share market underperformed the global developed markets. The S&P/NZX50 Index declined by -4.1% for the quarter. Major underperformers included a2 Milk (-28.6%), Meridian Energy (-27.4%) and Contact Energy (-20.7%). a2 Milk suffered from earnings downgrade following significant declines in sales of infant formula in China while the gentailers suffered due to overseas downweighting following index methodology changes for the iShares Global Clean Energy ETF. Notable outperformers included Fletcher Building (+20.0%) and Pushpay Holdings Ltd (+14.9%) due to better-than-expected earnings announcements.

Across the Tasman, the Australian sharemarket outperformed New Zealand with the S&P/ASX300 Index returning 5.7% over the quarter. The best performing sectors included financials, infotech and domestic 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 March 2021

outlook

New Zealand GDP declined by 1.0% during the December quarter to close out 2020 with a GDP decline of 2.9% for the full year. Although the country has managed the COVID-19 outbreak better than most developed countries, the snap lockdowns during the quarter slowed economic activity and also dampened the outlook as reflected by declines in the ANZ Consumer and Business confidence levels. The unsustainable bounce in retail spending (due to pent-up demand following the lockdowns last year) is also dissipating which may result in a further slowdown of business activity. Additionally, until the New Zealand borders are fully opened, the overall economy will remain smaller due to the direct impact on tourism and subsequent impact on retail, hospitality as well as education exports. A silver lining is the recent opening of borders to Australia which may provide some support to tourism. A lot depends on the country's ability to prevent further community outbreaks as well as successful execution of the government's vaccine rollout plan, which is currently tracking slightly behind schedule.

The Australian economy continued to recover following the COVID triggered recession earlier in the year. Australia GDP grew by 3.1% in the December quarter and registered a contraction of 1.1% for the full year 2020. The outlook in Australia is similar to New Zealand. While the country seems to be largely past the outbreak, sporadic hotspots continue to appear requiring targeted lockdowns. Furthermore, Australia's vaccine rollout is also tracking behind schedule due to logistical challenges.

For both New Zealand and Australia, the path to recovery is dependent on avoiding a resurgence of the outbreak, progress of their respective vaccine rollout plans and more crucially continued 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

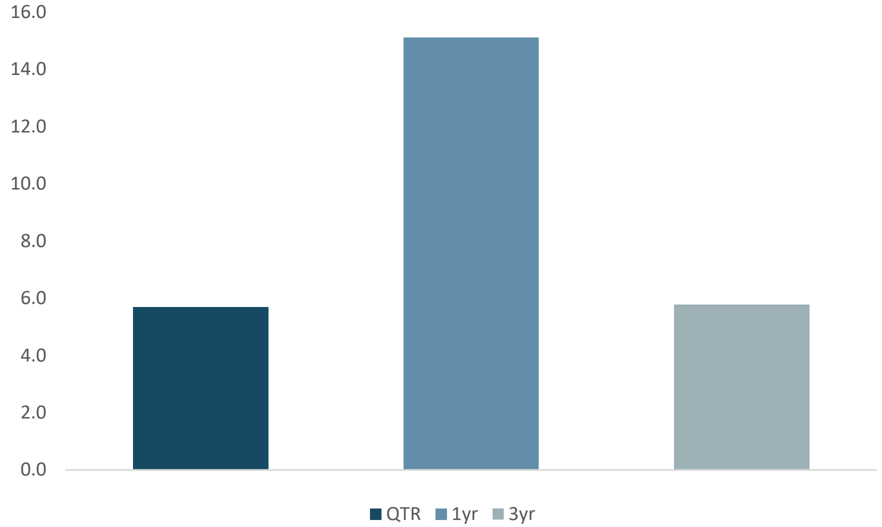
review

International infrastructure continued to rebound during the quarter. The S&P Global Infrastructure Index returned 5.7% over the quarter helped by some loosening of social restrictions by governments across the globe resulting in revenue generation from better 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 suppressed aeronautical revenues until the international travel restrictions are relaxed. This may happen earlier across some regions due to the progress of their respective vaccine rollouts provided 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 using public transport until the health crisis is fully contained.

International Infrastructure (NZD) – Trailing Returns (%)



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The price of oil has recovered from the lows of last year as demand for oil improves with the recovery of the global economy. This is expected to result in a recovery of revenues for energy infrastructure assets provided there are no further disruptions to the path to economic recovery as mentioned earlier.

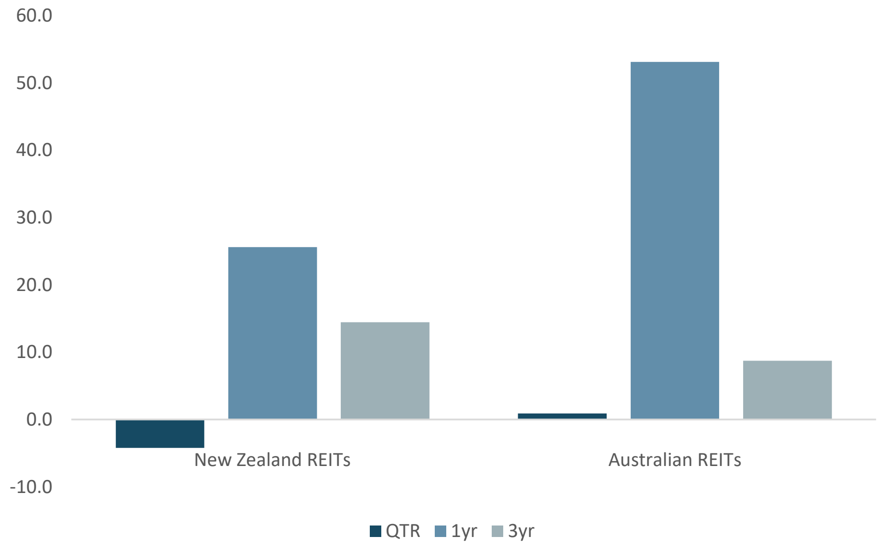
Governments of many developed economies have initiated significant infrastructure spending in a bid to create more jobs and help the respective economies recover from the fallout of the outbreak. This can result in new infrastructure assets for investment once complete as well as potentially better revenues from renovated infrastructure assets. Of note is the US government's recently announced infrastructure bill aiming to fix highways, rebuild bridges and upgrade ports, airports and transit systems.

Property

review

New Zealand listed property posted a negative quarter partly due to disruptions caused by the snap lockdowns but more importantly due to a sharp rise in domestic bond yields which is negative for the valuations of income-oriented assets such as property. The NZX All Real Estate Index declined by -4.2% over the quarter.

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



As at 31 March 2021

The Australian listed property market outperformed New Zealand with the S&P/ASX300 A-REITs Index recording a modest gain of 0.9% for the period despite a similarly sharp rise in local bond yields. This was driven by comparatively better economic recovery following successful management of the outbreak.

outlook

In principle, a rise in interest rates will negatively impact property asset valuations as was seen during the past quarter. However, at the time of writing bond yields across New Zealand and Australia were trending lower from the peak in March. This should result in near-term appreciation of property asset valuations. Additionally, interest rates are still low by historic standards which should continue to provide support to property valuations as well as compare less favourably to the higher property yields.

That said, tourism and related subsectors are likely to continue to struggle until international tourism fully returns. While retail is still witnessing somewhat lower demand than pre-COVID levels, it has seen a strong recovery due to the relatively better containment of the outbreak across Australasia. The office space subsector continues to face structural headwinds with a material part of the workforce preferring a hybrid approach of working remotely for part of the week versus working full-time at the physical office. As explained in previous commentaries, this may result in reduced demand for office space. Particularly, this does not bode well for new office space under development.

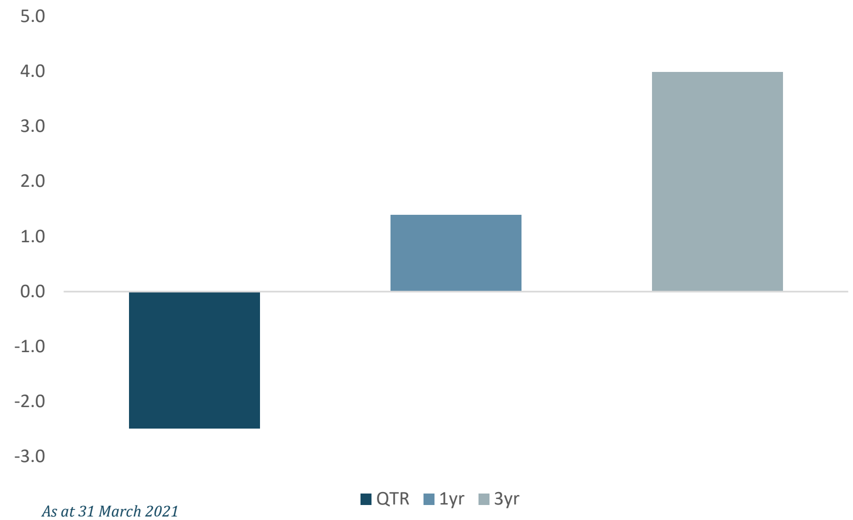
Lastly, the industrial subsector is expected to continue to benefit from greater demand for warehouses and logistics assets due to an accelerated advent of e-commerce and more recently due to gaps identified by supply chain disruptions.

international fixed interest

review

Bond yields across the major developed global economies rose sharply during the quarter due to optimism around economic reopening fuelling expectations of an earlier return of inflation which may force the central banks to raise interest rates. The US 10-year treasury rate increased sharply from 0.93% to 1.74% for the quarter. The 10-year yield on the German Bunds was still the lowest 10-year yield among the major developed economies despite increasing from -0.58% to -0.30% over the quarter. Japan's 10-year yield increased from 0.02% to 0.10% and the yield on the British 10-year Gilt rose from 0.20% to 0.84% for the period. Rising bond yields are negative for fixed income asset valuations. Accordingly, the Barclays Global Aggregate Index declined by -2.5% for the quarter.

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



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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 government and corporate 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. On the other hand, a further rise in bond yields may result in further declines in valuations of fixed income assets.

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 by historical standards due to the extensive policy support by central banks. That said, as the economies recover and the growth cycle gains momentum, inflation may also return which may result in rising bond yields thereby negatively affecting bond prices.

new zealand fixed interest and cash

review

The RBNZ maintained the official cash rate during the quarter at the historically low level of 0.25% despite the local economy recovering better than initial expectations due to successful management of the outbreak. The higher economic growth resulted in expectations of an earlier return of inflation triggering a sell-off in bonds which pushed the local bond yields sharply higher for the quarter. The New Zealand 10-year government bond yield rose from 1.02% to 1.82% during the quarter. As previously mentioned, an increase in bond yields negatively impacts bond valuations. Accordingly, the New Zealand Government Bond Index decreased by -2.5% for the quarter while the New Zealand A-grade Corporate Bond Index returned -2.1% for the period.

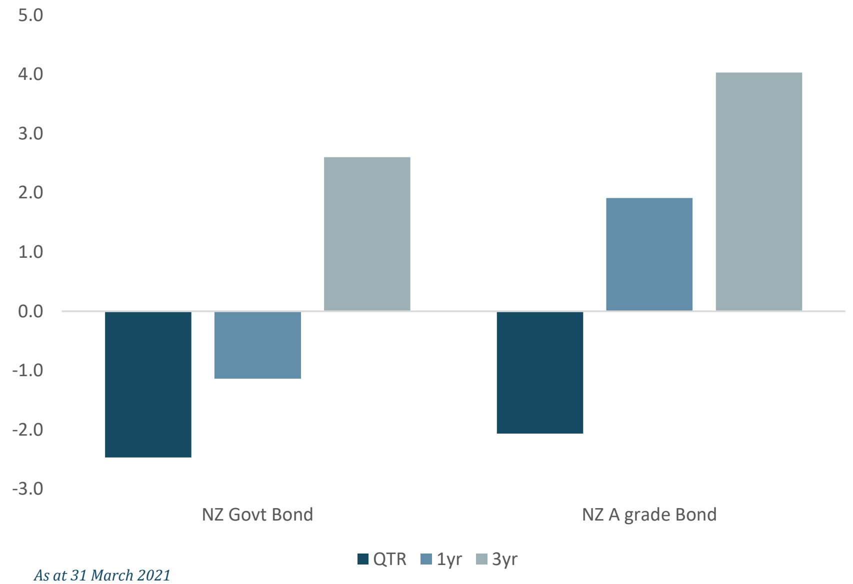
Despite the sharp rise in bond yields, the New Zealand dollar marginally depreciated against the US dollar due to a similarly sharp rise in US bond yields.

outlook

At its latest monetary policy review, the RBNZ maintained that while the broader economic recovery has been stronger than expected, the outlook remains uncertain. Tourism and related subsectors continue to be a drag to economic growth and there is a risk that weakness in these sectors may spill across rest of the economy. Accordingly, the RBNZ has cited commitment to maintaining policy support until the excess capacity in the economy is absorbed resulting in a sustainable return of high employment as well as inflation.

This environment indicates that local rates may stay at historically low levels for the short to medium term. This also means that term deposit rates may stay below inflation for the time being (ie not compensate enough to maintain purchasing power).

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



As at 31 March 2021

The outlook for the New Zealand dollar depends on the overall outlook for the pandemic and the progress of the economic recovery. Being a commodity currency, the New Zealand dollar may see further upside against the US dollar if the global economic recovery progresses without disruption.