markets summary – June 2023

Asset class	Review	Outlook
International equities	The second quarter of the year was positive for most share markets importantly with subdued volatility. The rally also appears to be broadening away from the technology sector with the consumer discretionary sector getting support from resilient consumer spending.	Most central banks are expected to maintain a restrictive policy stance for the coming months. However, if consumer spending holds up while inflation continues to fall, we expect cyclical sectors including financials, industrials, commodities and energy to also experience valuation upside like technology and consumer discretionary earlier this year. A further slowdown in the Chinese economy and potential stress in US regional banks are downside risks to this forecast.
Australasian equities	Both New Zealand and Australian shares had a positive quarter albeit lagged international share markets. The performance was driven by stronger than expected consumer spending.	The outlook for both New Zealand and Australia is for slower economic growth. New Zealand faces the risk of a relatively deeper recession if inflation doesn’t decline fast enough. Australia’s ecommerce, tourism and resources sectors continue to see resilient demand and RBA’s somewhat less restrictive stance may provide relative support for valuations.
International infrastructure	International infrastructure had a moderately positive quarter driven by the overall positive investor sentiment for the period.	The outlook for international infrastructure is stable. Airports may continue to take support from resilient international travel demand. Energy infrastructure may see revenue pressures over the medium term. Utilities infrastructure continue to offer investors diversification benefits with the potential for stable dividend yields.
Property	New Zealand and global listed property rebounded during the quarter with valuations taking support from the peaking of the current interest rate hiking cycle.	The retail sector may see revenue pressure as post-COVID pent-up demand normalises over the coming months. The office space sector will need to adjust to the hybrid work model while technology-related property assets may continue to see high demand and revenue support.
International fixed interest	Bond yields rose during the quarter as central banks reiterated their restrictive policy stance. Accordingly, the asset class experienced a flat return for the quarter, but still posted a decline for the past 12 months and the past three years.	With the current interest hiking cycle peaking, we maintain our expectations of flat to declining yields over the near term, which should provide support for bond valuations. With yields now at more normal levels after years at historical and unsustainable lows, bonds now offer better value and diversification benefits against short-term volatility in the share markets.
New Zealand cash and fixed interest	The RBNZ slowed then paused the OCR hikes during the quarter. The 10-year yield rose for the period following suit of rising yields overseas, which resulted in a subdued return by the asset class for the quarter. The New Zealand dollar moderately appreciated against the US dollar.	The RBNZ has cited commitment to bringing inflation within its target range via maintaining a restrictive policy. We expect the bond valuations to get support from declining yields as inflation drops over the coming months. The New Zealand dollar is likely to appreciate against the greenback over the medium-term with support for commodity currencies during the eventual economic recovery. Over the short-term, the currency movements will depend on the respective central bank’s policy stance relative to each other.

world and local economies & markets

markets rally continues with signs of broadening

Most share markets followed up the strong first quarter performance with a materially positive second quarter. It is worth noting that the positive performance over the second quarter came amid relatively subdued volatility unlike the first quarter where volatility was more evident.

Investor focus shifted from macro factors of high inflation and rising interest rates to fundamental factors such as corporate earnings and consumer spending. While most central banks appear to be near the peak of the current interest rate hiking cycle, they've maintained a restrictive policy narrative. This restrictive policy stance is expected to slow down economic growth for most developed economies in 2023.

An interesting observation is that share markets performance appeared to be broadening from previously being concentrated within the technology sector and in particular artificial intelligence related businesses. The consumer discretionary sector performed well with resilience in consumer spending. It may be that other sectors which have been unloved by investors so far this year start to get noticed with higher-than-expected earnings further broadening the rally this year.

It is worth noting here that financial markets are forward-looking, which means that while they may be volatile in the short-term, they will likely reflect the ensuing economic recovery before it eventuates.

Asset class returns were mostly positive for the quarter. The best performing asset class during the quarter was International Equities while New Zealand fixed interest was the only asset class to record a loss for the quarter. In general, growth assets outperformed defensive assets over the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	1.3	4.1	1.7	1.7
New Zealand Fixed Income	-0.8	0.1	-4.0	0.2
Global Fixed Income	0.1	-0.3	-3.1	0.6
New Zealand REITs	3.1	-0.7	1.1	4.4
Australian REITs	4.7	5.6	9.1	3.8
Global REITs	2.4	-7.6	3.7	-0.6
Global Infrastructure	1.7	4.8	11.6	6.5
New Zealand Equities	0.3	9.6	1.3	5.9
Australian Equities	2.5	12.4	11.7	7.0
Global Equities	9.1	20.3	14.1	11.3

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 30 June 2023.

international equities

review

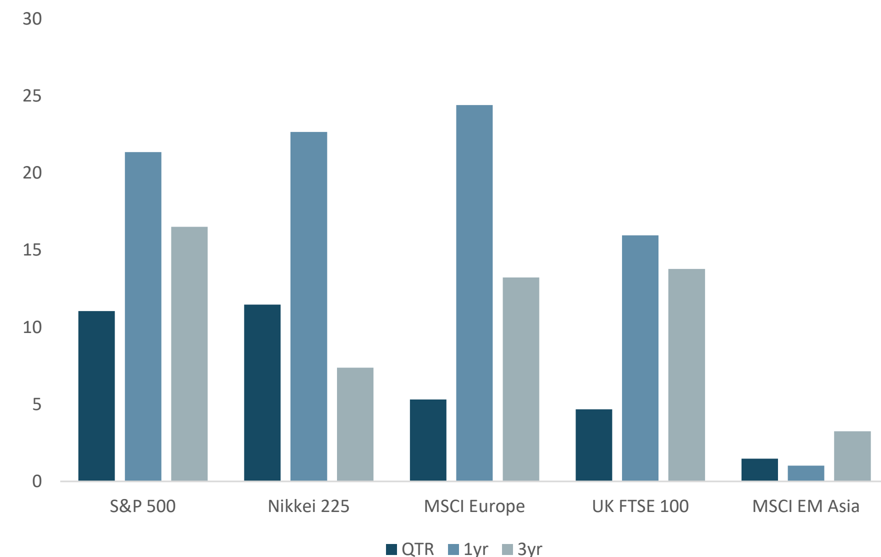
Share markets followed a positive first quarter with another strongly positive quarter. The S&P 500 ended up posting the second strongest performance for the first six months of the year since 1998.

The primary driver has been resilience in the labour market and consumer spending. The unemployment levels remain low for most developed economies and consumers appear to still have spending capacity from savings accumulated during COVID, which has helped the consumer discretionary sector outperform.

For the quarter, the S&P 500 and the Nikkei 225 indices rose strongly with returns of 11.0% and 11.5% respectively. The MSCI Europe and the FTSE also had a good quarter with returns of 5.3% and 4.7% as inflation started to decline which improved the medium-term economic outlook for the region.

Emerging markets underperformed relative to developed markets with the MSCI EM Asia reporting a modest gain of 1.5% for the quarter. While some emerging markets like Taiwan and India performed well, China underperformed with concerns that its post-COVID recovery was losing steam due to consumers holding back spending. Chinese consumers appear to be concerned about the future having endured an extended period of social and economic suffocation until late last year.

Regional Indices (NZD) – Trailing Returns (%)



As at 30 June 2023. 3yr returns are per annum (annualised).

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outlook

The World Bank expects the global GDP growth to decline to 2.1% in 2023 down from 3.1% in 2022. The main reason cited for this downward revision is the lagged impact from the monetary policy tightening implemented by most central banks across developed economies. The World Bank expects GDP growth to start to recover in 2024.

As per our forecasts in the last commentary, inflation has continued to decline progressively and the US Fed paused after hiking once during the quarter. That said, the US Fed has indicated further hikes may be coming this year, which we did not expect. Other central banks are also expected to maintain a restrictive policy stance to varying degrees at least for the coming months.

In our last few commentaries, we had maintained that most developed economies will experience a mild recession which will help bring down inflation. This expectation of a mild recession stemmed from our belief that consumer spending will falter resulting in reduced business earnings. As mentioned earlier, it appears the consumer still has capacity to spend thereby supporting business earnings and providing further upside for valuations. The goldilocks scenario is where inflation declines to target without the economy undergoing a recession. At least at this stage it seems the US may see inflation drop down to target without its economy experiencing a recession. Once inflation is deemed to be structurally at or below target, the US Fed can be expected to ease their monetary policy stance. This monetary easing will support asset valuations while encouraging economic growth. Since financial markets are forward-looking, we may see further upside in valuations ahead of the actual monetary policy easing.

A downside risk is that stress appears within the regional banking sector stifling economic growth through reduced availability of credit which may result in failure of highly leveraged businesses. Another point of concern is the unexpected sputtering of growth in the Chinese economy since moving past its COVID-Zero policy late last year. Being the second largest economy, a further or prolonged slowdown there could hamper the global economic recovery next year.

Coming back to the US, if consumer spending holds up while inflation continues to fall, we will likely see cyclical sectors benefit. These include financials, industrials, commodities and energy. Note that the strong performance so far this year has been led by technology on the back of optimism around the potential of artificial intelligence followed by consumer discretionary benefiting from resilient consumer spending.

Holistically, we expect share markets to be positive in the coming months albeit with volatility on the way, providing buying opportunities for investors with cash in hand.

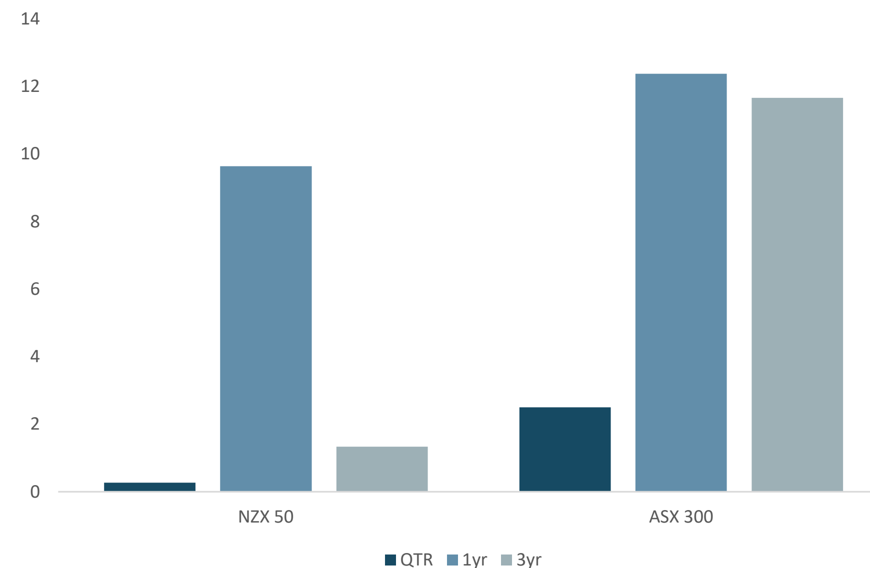
australasian equities

review

The New Zealand share market was marginally positive but lagged the major international share markets with the S&P/NZX50 Index rising by 0.3% for the quarter. A notable strong performer was Serko (56.9%) with strong travel trends providing a tailwind for its partnership with Booking.com. Notable decliners included Pacific Edge Ltd (79.1%) and EBOS Group Ltd (21.0%). Pacific Edge Ltd lost Medicare coverage in the US for its key product, Cxbladder, while EBOS Group Ltd lost a large distribution contract with the Chemist Warehouse.

Across the Tasman, the Australian share market also underperformed the major international share markets with the S&P/ASX300 Index returning 2.5% for the period. Ecommerce, miners and tourism were the outperforming sectors while retail struggled during the quarter.

Australasian Equities (NZD) – Trailing Returns (%)



As at 30 June 2023. 3yr returns are per annum (annualised).

outlook

The New Zealand economy continues to take support from resilient demand albeit the combination of higher living costs and a restrictive monetary policy has tipped the economy into a shallow recession as per our forecast in the previous commentary. With consumers and businesses still feeling the pinch, their spending may be cut further over the coming months which may intensify the recessionary effects. In theory, an economic recession should lower inflation. That said, the local labour market remains tight putting pressure on wages which is inflationary. We expect the RBNZ to hold rates at a restrictive level until inflation falls to be within the target range. While the pause in interest rate hikes may alleviate headwinds for valuations, the downside risk remains

with further rate hikes needed if inflation does not decline fast enough and the prospect of declining earnings from a deeper recession.

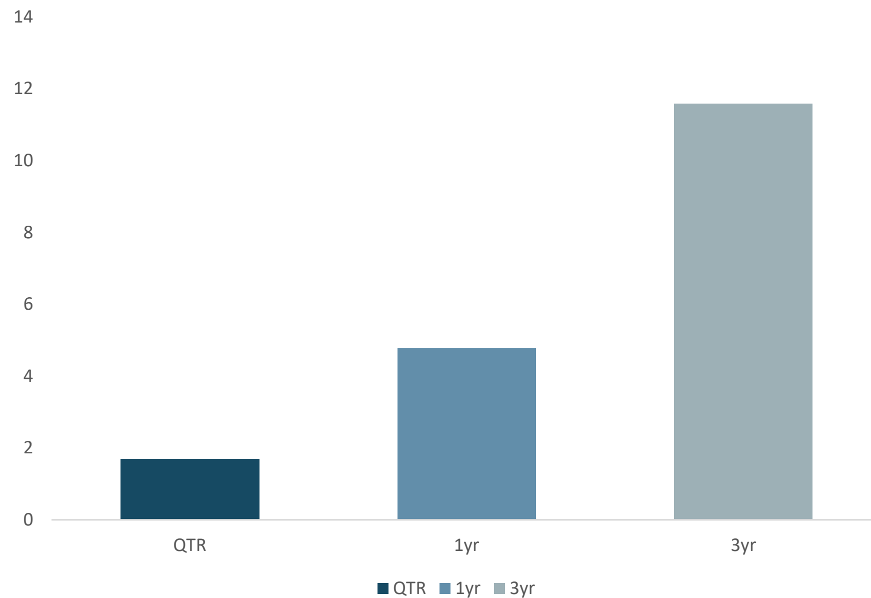
The Australian economy is in a slightly better place than New Zealand. Consumer spending remains resilient across ecommerce and tourism while the mining sector is expected to see increased demand for materials, particularly lithium where inventory levels of EV manufacturers have normalised after building up post COVID. Additionally, the RBA has adopted a slightly less restrictive stance compared to the RBNZ which may be seen as somewhat supportive for asset prices on a relative basis in the near term. It is worth noting that consumer spending from the younger cohort of the population may be subject to greater pressure from the rising cost of living which may create downside risk for the financial sector.

international infrastructure

review

International infrastructure had a moderately positive quarter with the S&P Global Infrastructure Index recording a gain of 1.7% for the period benefiting from the positive investor sentiment in general.

International Infrastructure (NZD) – Trailing Returns (%)



As at 30 June 2023. 3yr returns are per annum (annualised).

outlook

The outlook for international infrastructure as an asset class looks stable. Airports may still continue to see healthy aeronautical revenues in the near term driven by international travel, which shows no signs of slowing down as yet from the post-COVID highs. Toll roads and bridges should continue to see strong traffic and thereby revenue support. The price of oil has moved sideways but the outlook looks a bit uncertain with the backdrop of a slowing Chinese economy, the largest importer of the commodity in the world. Accordingly, although energy infrastructure assets may continue to see revenue support for now, the medium-term outlook appears to be more uncertain.

Lastly, utilities infrastructure offers investors diversification benefits through a stable dividend yield during heightened volatility in other share market sectors.

Property

review

New Zealand and global listed property rebounded during the quarter with the NZX All Real Estate Index gaining 3.1% for the period. The S&P/ASX300 A-REITs Index recorded a return of 4.7% while the FTSE EPRA Nareit Index also posted a material gain of 2.4% over the period.

Listed Property (NZD) – Trailing Returns (%)

As at 30 June 2023. 3yr returns are per annum (annualised).

As per our expectation in the last commentary, the peaking of monetary tightening across most economies eased headwinds on property valuations. We would also point out that as per our forecast, New Zealand listed property underperformed compared to Australian listed property, however, marginally outperformed global listed property.

outlook

In New Zealand, we expect inflation to be more persistent which may mean the RBNZ stays more restrictive for longer relative to other central banks. Therefore, we maintain that New Zealand listed property may underperform compared to Australian and global listed property over the coming months.

Among the subsectors, retail faces the risk of slower consumer spending as the post-COVID pent-up demand normalises. High-quality modern office space may be sought after but at the expense of existing office space as the total demand is expected to stay lower than pre-pandemic levels with the advent of the hybrid work model. Within the industrial subsector, demand for warehouses and logistics assets will persist medium to long-term due to the continued advent of ecommerce. Lastly, technology-related property assets such as Datacentres and Telecom towers will also see resilient demand and revenue support.

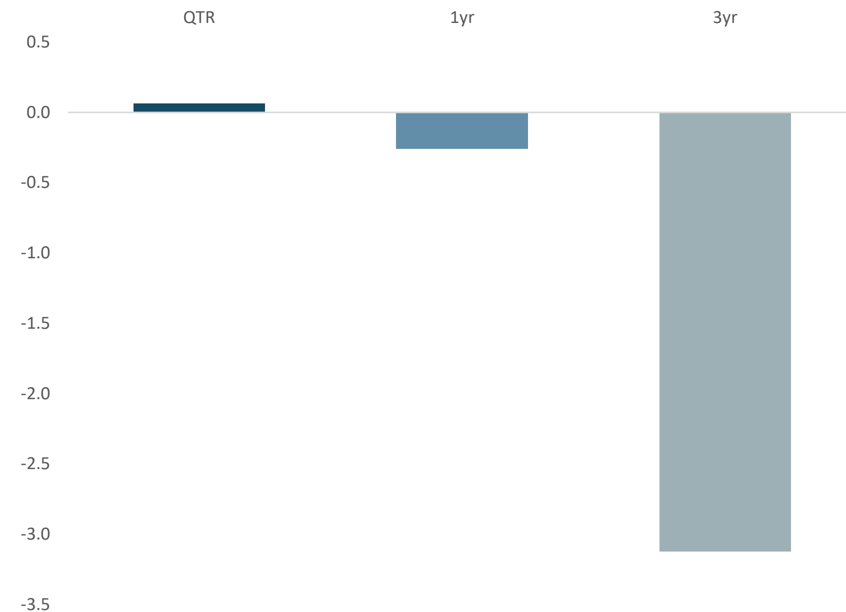
As mentioned earlier, we feel recessionary impacts may become more pronounced in New Zealand later this year. A worsening of economic conditions presents a headwind because rental yields may be compromised due to business failures and sluggish lease renewal activity.

international fixed interest

review

Most central banks appear to be at or near the peak of the current interest rate hiking cycle. However, bond yields rose across most major economies as central banks persisted with their narrative to maintain a restrictive stance for longer. The US 10-year treasury rate rose from 3.49% to 3.82% during the quarter. The yield on the British 10-year Gilt increased sharply from 3.47% to 4.39% over the period. While Japan remains an outlier among developed economies due to its persistence with an expansive policy, its 10-year yield followed suit of other developed economies rising from 0.33% to 0.40% during the quarter. With the rise in yields during the quarter, the Barclays Global Aggregate Index remained flat with a marginal gain of 0.1% for the period. Despite posting a positive return for three consecutive quarters, the asset class still shows a marginally negative return of 0.3% over the past 12 months and a loss of 3.1% p.a. for the last three years.

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



As at 30 June 2023. 3yr returns are per annum (annualised).

outlook

As mentioned earlier, with inflation appearing to have peaked, central banks are near or at the peak of the current interest rate hiking cycle. Accordingly, we maintain our forecast of flat to declining yields over the medium term.

This means the valuations for the asset class may see further support over the medium term. Importantly, International Fixed Interest as an asset class continues to provide diversification benefits due to its relatively lower volatility compared to shares. Furthermore, the significant increases in yields over the last year or so mean there are increasing opportunities to invest in good quality bonds paying a reasonable yield which is a useful buffer against high short-term volatility in share markets.

new zealand fixed interest and cash

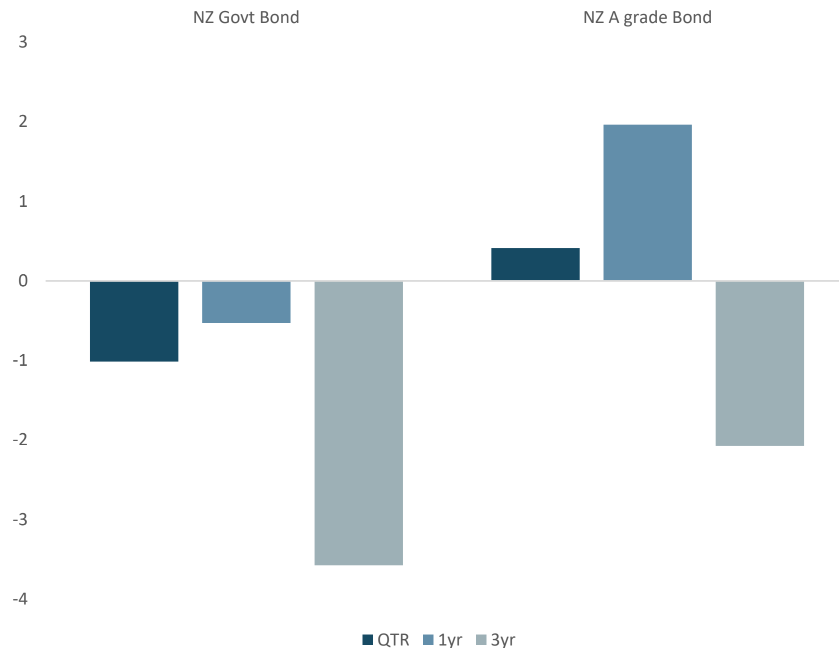
review

As per our forecast, the RBNZ slowed and paused its interest rate hiking cycle raising its official cash rate once during the quarter by 25bps to take it from 5.25% to 5.5%. This and the rise in global yields saw the New Zealand 10-year government bond yield rising from 4.23% to 4.65% during the quarter.

The rise in yields resulted in the asset class providing a subdued return with the New Zealand Government Bond Index posting a modest loss of 1.0% for the quarter while the New Zealand A-grade Corporate Bond Index was flat with a return of 0.4% for the period. Similar to international fixed interest, the asset class has experienced unusually high negative returns over the past 3 years on the back of a significant rise in bond yields over the past 18 months or so.

With a slightly stronger rise in yields during the quarter and a relatively more restrictive monetary policy stance by the RBNZ, the New Zealand dollar closed the quarter moderately higher against the US dollar.

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



As at 30 June 2023. 3yr returns are per annum (annualised).

outlook

At its latest monetary policy review, the RBNZ noted economic growth to be slowing due to the higher borrowing costs for consumers and businesses creating a negative wealth effect. Our forecast of the local economy going into a recession has also come true. As mentioned earlier, we expect the recessionary impacts to become more pronounced over the coming months because the RBNZ appears committed to maintaining interest rates at a restrictive level until inflation comes down to the middle of the target range (1-3%). Our outlook for a more pronounced recession in New Zealand is supported by the RBNZ's conclusion that the current employment level remains unsustainably high, which means unemployment may be allowed to rise to help ease inflation. As inflation eases, we expect yields to drop in anticipation of the RBNZ lowering the OCR from restrictive levels. In theory, this backdrop should provide support for bond valuations.

Additionally, New Zealand fixed interest is increasingly offering decent yields and offers a buffer against heightened volatility in the share market.

The medium to longer term outlook for the New Zealand dollar will depend on the global economic recovery beyond the current slowdown. Being a commodity currency, the New Zealand dollar tends to appreciate against the US dollar during periods of global economic recovery. Over the short-term the currencies will continue to reflect the respective central bank policies with the more restrictive central bank potentially resulting in relative appreciation of its currency.