Saturn Advice
Creating a richer life

markets summary – December 2023

Asset class	Review	Outlook
International equities	Most share markets had a strong quarter to close the year positively. This was largely driven by investors pricing in lower central bank interest rates in 2024 in the belief inflation will continue to fall from current levels.	Most central banks are expected to ease their restrictive policies albeit slowly. As a result, most economies are likely to experience sluggish growth over the near term. We believe that high-quality companies (outside of the tech sector which has enjoyed a strong run of late) offer good value. Geographically, the US economy looks more resilient and growth in the Indian economy looks promising.
Australasian equities	Both New Zealand and Australian shares had a materially positive quarter with New Zealand underperforming on a relative basis. Both share markets benefitted from declining yields in fixed interest markets.	The outlook for both New Zealand and Australia is for slower economic growth. The New Zealand economy is benefitting from high net immigration but may be in a recession regardless. Australia's ecommerce, tourism and resources sectors continue to see resilient demand and RBA's somewhat less restrictive stance due to declining inflation may provide relative support for valuations of quality companies.
International infrastructure	International infrastructure had a strongly positive quarter with valuations of infrastructure assets driven higher by declining fixed interest yields.	The outlook for international infrastructure is mixed. Airports may see revenue normalisation. Energy infrastructure could see revenue pressures over the medium term. Utilities infrastructure continues to offer investors diversification benefits with the potential for stable dividend yields.
Property	Listed property was the best performing asset class for the quarter with property valuations appreciating due to declining yields in fixed interest.	The retail sector may come under revenue pressure in the coming months if consumers curb spending due to the higher cost of living, albeit there may be support from high net immigration in New Zealand. Modern office space will be in demand although overall office space demand will remain lower than pre-pandemic levels. Technology-related property assets may continue to see high demand and revenue support.
International fixed interest	Bond yields declined during the quarter as central banks softened their restrictive policy stance. Accordingly, the asset class experienced a strong positive return for the quarter.	With the central banks softening their restrictive policy stance, we maintain our expectations of declining yields over the medium term, which should provide further support for bond valuations. With yields now approaching more normal levels after years at historical lows, bonds offer good value and diversification benefits against short-term volatility in the share markets.
New Zealand cash and fixed interest	The RBNZ maintained the OCR, however, the 10-year yield declined sharply for the period following suit of declining yields overseas, which resulted in a strong return by the asset class for the quarter. The New Zealand dollar appreciated against the US dollar.	The RBNZ has cited commitment to bringing inflation within its target range via maintaining a restrictive policy. We expect bond valuations to get support from declining yields as inflation continues to fall over the medium term. The New Zealand dollar is likely to appreciate against the greenback over the medium-term, as commodity currencies tend to appreciate during times of economic recovery. In the short-term, currency movements will likely be more influenced by central bank interest rates.

world and local economies & markets

markets finish the year with a bang

Most share markets had a strongly positive quarter after a materially negative third quarter. This was largely driven by optimism around declining inflation potentially leading to an easing in the policy stance of central banks. This optimism may well be justified as the US Fed has signalled it is likely to start cutting rates in 2024.

However, while central banks generally appear to be softening their narrative, the risk is markets get ahead of themselves on how quickly rates will be cut. Rates could remain higher than markets are anticipating for much of 2024 unless an exogenous shock or a drastic worsening of economic conditions (e.g. a sharp rise in unemployment) warrants a faster loosening of monetary policy. This means that economic growth is likely to remain sluggish over the near term.

A loosening of monetary policy will ultimately result in lower interest rates which is supportive of higher asset valuations and will eventually support economic growth over the medium term. As we've explained in the past, financial markets are forward-looking. This means that the recent rally may be reflecting at least some of the economic recovery, which is yet to eventuate.

It is worth mentioning that the ongoing armed conflicts, the resulting disruption of trade routes (eg. Houthi attacks in the Red Sea) and geopolitical tensions around Taiwan pose a risk of a relapse of inflation.

All asset class returns were positive for the quarter. The worst performing asset class was New Zealand cash while Australian and International property were the best performing asset classes. Apart from these asset classes, growth assets and defensive assets had similar returns over the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	1.4	5.4	2.7	2.1
New Zealand Fixed Income	6.6	6.1	-2.6	0.5
Global Fixed Income	5.7	6.6	-2.4	1.0
New Zealand REITs	6.5	5.5	-5.5	2.9
Australian REITs	16.9	17.5	6.1	7.0
Global REITs	13.1	8.4	1.9	2.5
Global Infrastructure	5.1	5.7	9.8	7.7
New Zealand Equities	4.2	2.6	-3.5	6.0
Australian Equities	8.7	12.7	9.2	10.8
Global Equities	5.7	23.7	12.0	14.1

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 31 December 2023.

international equities

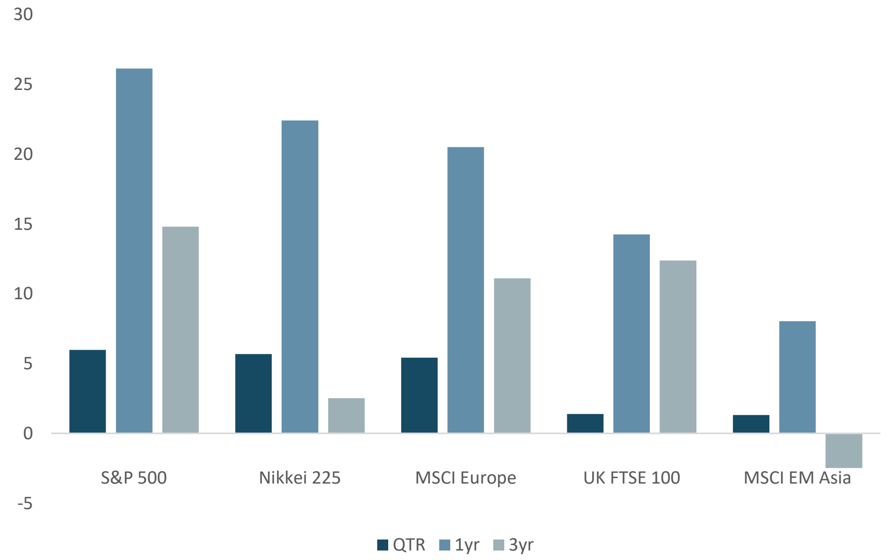
review

As mentioned earlier, most share markets had a strongly positive quarter after a materially negative third quarter. Yields dropped as concerns around persistent inflation dissipated and investors priced in lower interest rates anticipated for later in 2024 from an easing of policy stance of central banks.

For the quarter, the S&P 500 surged by 6.0% followed by the Nikkei 225 index rising by 5.7% and the MSCI Europe which increased by 5.4% over the period. The FTSE 100 lagged with an increase of 1.4% for the quarter.

Emerging markets also underperformed relative to most major developed markets. The MSCI EM Asia reported an increase of 1.3% for the quarter. While some emerging markets like India performed well, China underperformed amid concerns of a slowing economy, sluggish manufacturing output, lower export orders and deflation while credit concerns also persist in the real estate sector.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 December 2023. 3yr returns are per annum (annualised).

outlook

As previously mentioned, central banks appear to be softening their policy stance which may result in easing of monetary policy over the medium term. This easing will support asset valuations and also help economic growth. That said, the policy is expected to remain restrictive over the near term thereby providing a headwind for economic growth.

In our last commentary, we noted our expectation for a mild recession for developed economies. Despite the softening in policy stance by central banks, we believe the risk of a mild recession remains. However, it may be that a mild recession eventuates in a rolling fashion across sectors rather than across entire economies all at once. This means that different sectors of economies may experience a mild recession at different times which could result in economies experiencing sluggish growth overall without tipping into a recession.

We do not anticipate a deep or prolonged recession because inflation appears to be declining towards acceptable levels, which will allow central banks to ease their respective monetary policies. In theory, this monetary easing will support asset valuations while encouraging economic growth.

An interesting note is that wage inflation is persisting, which means that consumers still have spending capacity, which may support business activity thereby sustaining business earnings. This backdrop also supports our view that most developed economies may not experience a widespread or deep recession.

As noted earlier, most share markets experienced a strongly positive December quarter and by doing so, posted a very positive 2023. We believe that while there may be volatility and short periods of negative performance, 2024 may also be a positive year on the whole. The strong share market performance in 2023 was largely driven by the technology sector expected to benefit from the advent of artificial intelligence. It was only towards the end of the year that other sectors also started to participate in the rally. This means the valuations across most sectors are still below their late 2021 peaks. The downside risk is from a major escalation in any of the ongoing armed conflicts and geopolitical tensions, which could affect commodity prices (particularly energy) and refuel inflation.

All in all, we believe that high-quality companies outside of technology offer good value over the medium term. Geographically, the US economy looks more resilient than Europe and growth in the Indian economy looks promising amongst emerging markets.

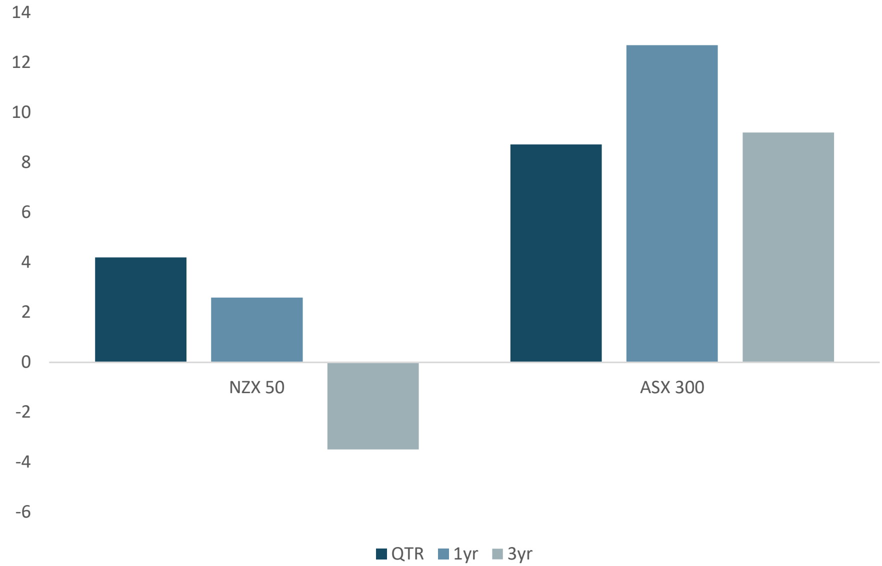
australasian equities

review

The New Zealand share market posted a strong quarter but still underperformed major international share markets. The S&P/NZX50 Index rose by 4.2% for the quarter. Notable outperformers included Stride Property Group (13.4%) and Sky Television Network (13.0%). Stride Property Group benefited from declining yields while Sky Television Network appreciated from news of a potential buyer, which subsequently didn't proceed.

Across the Tasman, the Australian share market had a stellar quarter with the S&P/ASX300 Index rising 8.7% for the period. Most sectors had a positive quarter with miners being the relative outperformers for the period.

Australasian Equities (NZD) – Trailing Returns (%)



As at 31 December 2023. 3yr returns are per annum (annualised).

outlook

As per our previous forecasts, consumers and businesses are feeling the pinch from the rising cost of living and higher cost of borrowing. While a slowdown in demand is expected from these cost pressures, there may be support for economic activity from high net immigration in recent months. The labour market is now showing signs of easing with a decline in job listings due to new migrants filling positions and businesses delaying hiring to manage costs. This may ease wage inflation, however, inflationary impact from higher net immigration remains to be seen. We expect the RBNZ to hold the rates at a restrictive level until inflation falls to within the target range. New Zealand's primary commodity exports are expected to see headwinds as global demand stays sluggish.

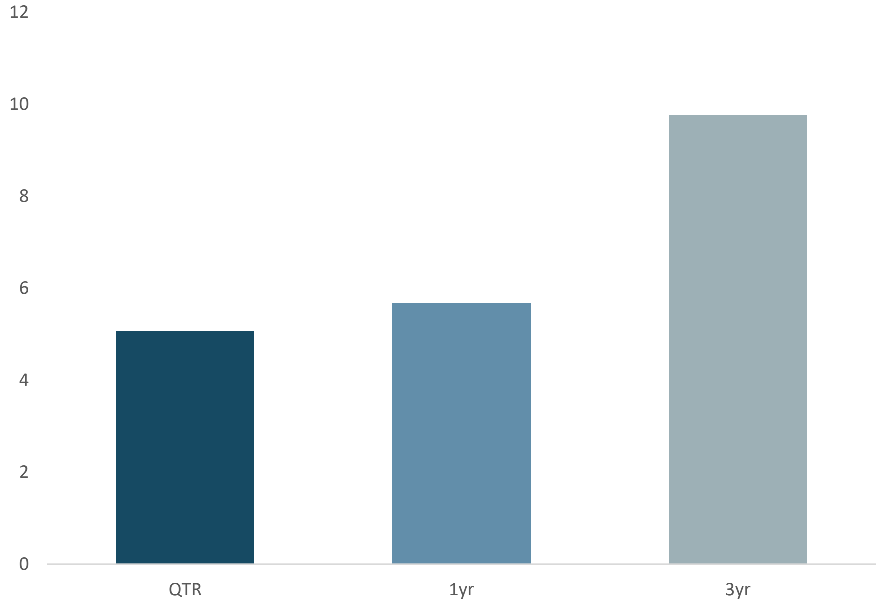
The Australian economy is in a slightly better place than New Zealand. While inflation remains much higher than target, it is declining faster. Consumer spending remains resilient across ecommerce and tourism while the mining sector is expected to see increased revenues due to higher commodity prices. We expect the RBA to maintain a restrictive monetary policy stance at least for the near term. This can subdue economic growth, however, if consumer spending remains persistent the restrictive policy effects on economic growth may be offset at least to some extent. High quality defensive companies, particularly in the healthcare sector offer good value over the medium term.

international infrastructure

review

International infrastructure had a significantly positive quarter with the S&P Global Infrastructure Index recording a gain of 5.1% for the period as declining yields supported the infrastructure asset valuations.

International Infrastructure (NZD) – Trailing Returns (%)



As at 31 December 2023. 3yr returns are per annum (annualised).

outlook

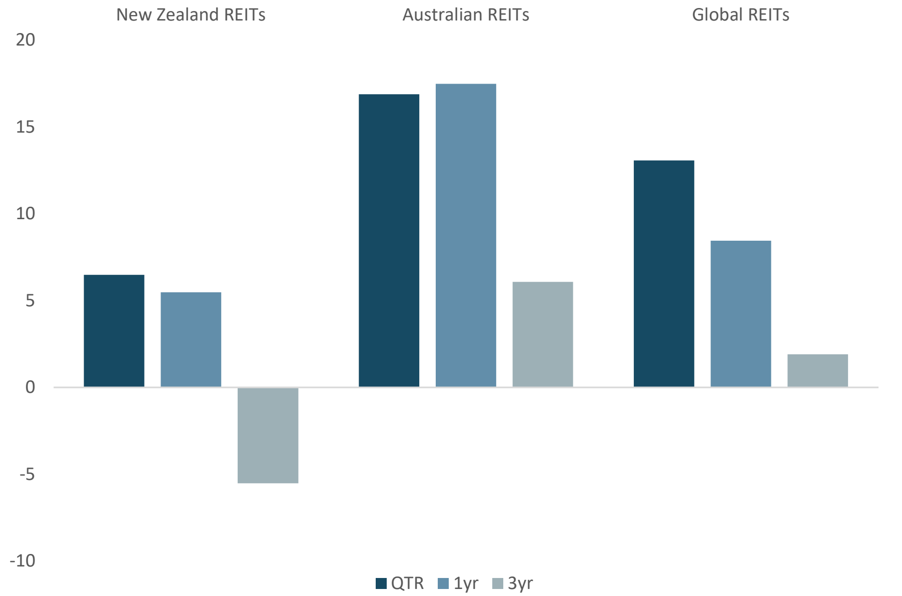
The outlook for international infrastructure as an asset class looks mixed. Airports continue to see healthy aeronautical revenues driven by international travel. However, international travel demand may cool off as consumer discretionary spending slows. Toll roads and bridges should continue to see strong traffic and thereby revenue support. The price of oil declined on concerns of oversupply against the backdrop of a slowing Chinese economy, the largest importer of the commodity in the world. Accordingly, the outlook for energy infrastructure assets appears to be uncertain. Lastly, utilities infrastructure offers investors diversification benefits through a stable dividend yield during heightened volatility in other share market sectors.

property

review

Listed property was the best performing asset class during the quarter with property asset valuations rising due to declining yields. The NZX All Real Estate Index rose 6.5% for the period while the S&P/ASX300 A-REITs Index and the FTSE EPRA Nareit Index recorded significant gains of 16.9% and 13.1% respectively over the quarter.

Listed Property (NZD) – Trailing Returns (%)



As at 31 December 2023. 3yr returns are per annum (annualised).

outlook

As per our previous commentary, property asset valuations appreciated as yields declined. We believe that yields will fall further over the medium term thereby providing further upside to property asset valuations. That said, downside risk remains in an escalation of ongoing armed conflicts and geopolitical tensions resulting in resurgence of inflation and therefore higher yields.

Among the subsectors, retail faces the risk of slower consumer spending as the higher cost of living continues to bite albeit there is support in New Zealand from high net immigration. 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. 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.

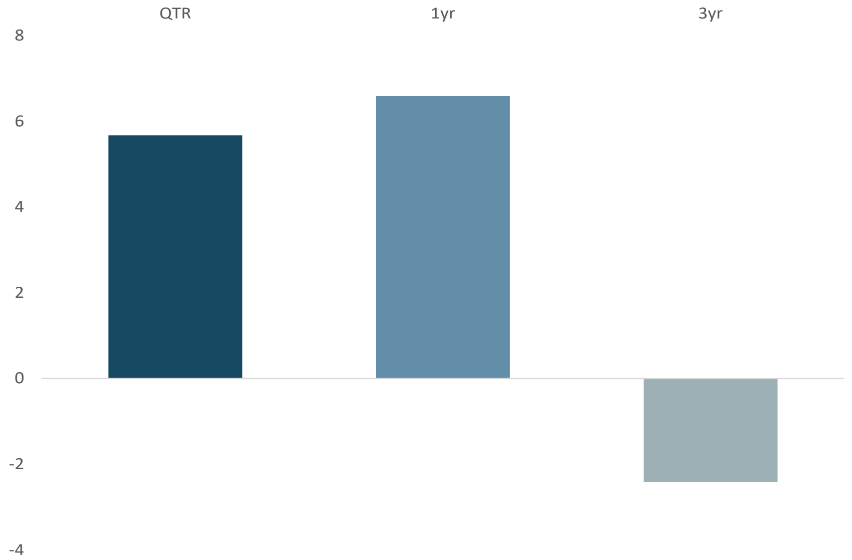
As mentioned earlier, we feel the impact of an economic slowdown may become more pronounced in New Zealand later this year. A worsening of economic conditions presents a headwind because rental yields may be compromised due to business failures and sluggish lease renewal activity.

international fixed interest

review

With the US Fed pivoting to a softening of its restrictive policy stance, bond yields declined across most major economies. The US 10-year treasury rate dropped sharply from 4.57% to 3.87% during the quarter. The yield on the British 10-year Gilt also declined significantly from 4.46% to 3.54% 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 decreasing from 0.77% to 0.62% during the quarter. With the sharp decline in yields during the quarter, the Barclays Global Aggregate Index reported a significant gain of 5.7% for the period. Although the longer-term return is still unusually negative at 2.4% for the last 3 years due to the aggressive rise in yields over 2022-23, the 12-month return is now firmly positive at 6.6% as a result of the normalisation of yields and a low starting point 12 months ago.

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



As at 31 December 2023. 3yr returns are per annum (annualised).

outlook

As per our previous commentaries, we maintain that inflation has peaked, and on the way down. Therefore, most central banks are near or at the peak of the current interest rate cycle. Accordingly, we expect declining yields over the medium term albeit there may be shorter-term spikes due to unexpected events e.g. a geopolitical conflict.

This means the valuations for the asset class are likely to receive further support over the medium term. Again, there may be valuation downside in the short-term if there is a spike in yields.

Importantly, International Fixed Interest as an asset class continues to provide diversification benefits due to its relatively lower volatility compared to shares. Finally, the significant increases in yields over the last two years mean there are increasing opportunities to invest in good quality (investment-grade) bonds paying an attractive yield which is a useful buffer against higher short-term volatility in share markets.

new zealand fixed interest and cash

review

The RBNZ maintained its official cash rate at 5.5%. However, the sharp decline in global yields swayed the New Zealand 10-year government bond yield which also dropped sharply from 5.34% to 4.39% during the quarter.

The decline in yields resulted in the asset class providing a significant return with the New Zealand Government Bond Index posting a substantial return of 5.2% for the quarter while the New Zealand A-grade Corporate Bond Index also experienced a strong gain of 5.0% for the period. Similar to international fixed interest, the asset class has experienced the unusual occurrence of negative returns for the past 3 years on the back of a significant rise in bond yields over the past two years.

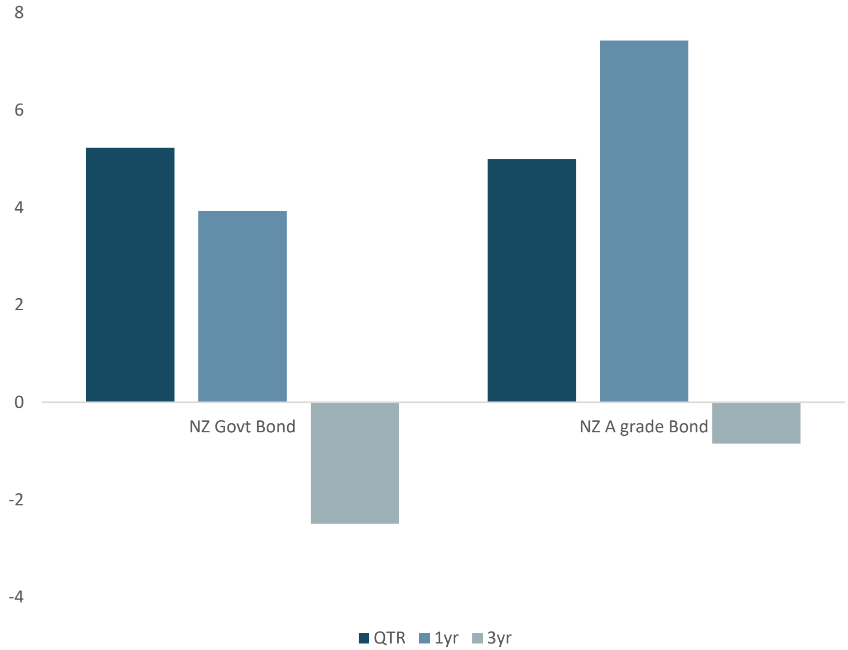
Despite a sharper decline in yield, the New Zealand dollar appreciated against the US dollar due to the US Fed's pivot to a slightly softer tone on restrictive policy while the RBNZ maintained its restrictive narrative.

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. The recessionary impacts may become more pronounced over the coming months because the RBNZ appears committed to maintaining interest rates at a restrictive level until inflation (5.6% as at September '23) comes down to the middle of the target range (1-3%).

That said, the high net immigration in recent months has provided support to economic activity, which may somewhat offset recessionary headwinds.

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



As at 31 December 2023. 3yr returns are per annum (annualised).

We expect yields to drop in anticipation of the RBNZ lowering the OCR from restrictive levels over the medium term. In theory, this backdrop should provide support for bond valuations over the medium term. Near term, yields may still be swayed by movement in global yields.

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 this period of sluggish growth. 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, currencies will continue to reflect their respective central bank policies and interest rates, with the more restrictive central banks potentially resulting in relative appreciation of their currencies.