Saturn Advice
Creating a richer life

markets summary – March 2024

Asset class	Review	Outlook
International equities	Most share markets had a strong quarter to start 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 still expected to ease their restrictive policies albeit slowly. As a result, most economies are likely to experience sluggish growth over the near term so there is room for re-adjustment following a very strong rally. Nevertheless, we believe that high-quality companies (outside of the tech sector which has enjoyed a strong run of late) offer good value over the medium term. 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 positive quarter with New Zealand underperforming on a relative basis. Both share markets benefitted from the widespread rally in global share 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 continue to slowdown regardless. Australia's energy and resources sectors may see demand from China. Both economies will face headwinds from the restrictive stance of the respective central banks.
International infrastructure	International infrastructure also participated in the strong widespread rally during the quarter.	The outlook for international infrastructure is mixed. Airports may see revenue normalisation. Energy infrastructure could see revenue boost if there is escalation in armed conflicts. Utilities infrastructure continues to offer investors diversification benefits with the potential for stable dividend yields.
Property	Listed property provided mixed bag returns. New Zealand listed property was the worst performing asset class while Australian listed property was the best performing asset class for the quarter. International listed property also lagged.	The retail sector has seen persistent demand but may come under revenue pressure in the coming months if consumers curb spending due to the higher cost of living. 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. We favour international exposure for listed property over the medium term.
International fixed interest	Bond yields rose during the quarter on the back of heightened geopolitical tensions and risk of escalation in armed conflicts. Accordingly, the asset class experienced a flat return for the quarter.	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 rose for the period following suit of rising yields overseas, which resulted in a flat 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 the 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 March year with a bang

Most share markets followed on the strong finish to last year with another strongly positive quarter to start 2024. This was largely driven by expectation that interest rates have peaked and that central banks will start cutting their policy rates.

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 partially, the expectation of an economic recovery which is yet to eventuate. This may also mean that there may be room for markets to re-adjust following a very strong run.

It is important to note that an escalation in any of the various ongoing armed conflicts and geopolitical tensions poses a risk of a relapse of inflation.

All asset class returns were positive for the quarter. The worst performing asset classes were International fixed interest and New Zealand listed property while Australian listed property and International equities were the best performing asset classes. Overall, growth assets outperformed defensive assets over the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	1.4	5.7	3.1	2.2
New Zealand Fixed Income	0.1	3.6	-1.6	-0.1
Global Fixed Income	0.0	3.8	-1.6	0.5
New Zealand REITs	0.0	3.6	-4.2	1.3
Australian REITs	17.6	37.9	11.6	7.7
Global REITs	1.1	9.7	-0.6	0.1
Global Infrastructure	7.0	7.9	10.2	6.7
New Zealand Equities	2.8	1.9	-1.2	4.2
Australian Equities	6.7	16.6	9.5	10.2
Global Equities	15.3	30.9	14.5	15.0

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 31 March 2024.

international equities

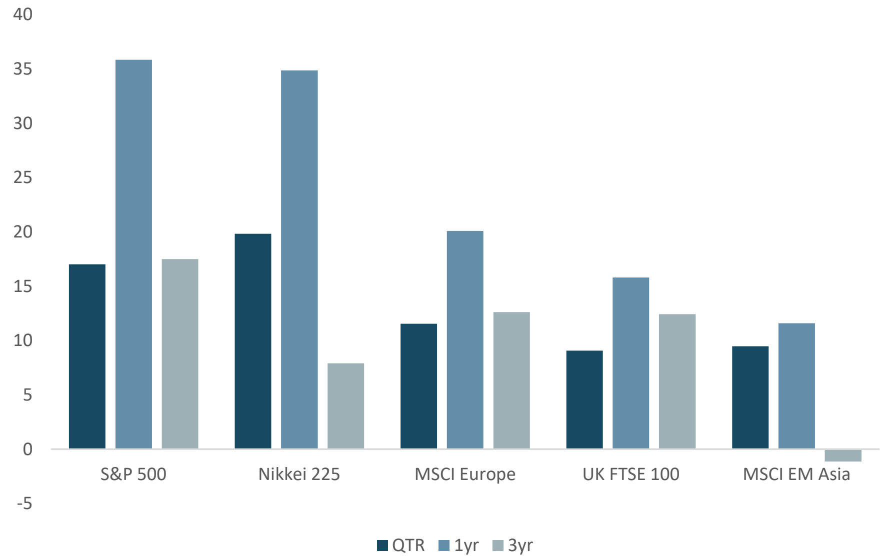
review

As mentioned earlier, most share markets had another strongly positive quarter after a strong finish to 2023. Earnings beat expectations albeit this was partially due to earnings expectations having been lowered last year in anticipation of a recession which hasn't arrived.

For the quarter, the S&P 500 surged by 17.0% while the Nikkei 225 index rose by a whopping 19.8% and in the process surpassed its previous all-time high going back to 1989. The MSCI Europe also had a stellar quarter rising by 11.6% over the period while the FTSE 100 followed suit with a substantial increase of 9.1% for the quarter.

Even the emerging markets participated in the widespread rally during the quarter. The MSCI EM Asia recorded a significant increase of 9.5% for the quarter. While some emerging markets like India continued to performed well, there was now optimism that the Chinese economy might be able to re-ignite growth with monetary policy support following a prolonged post-COVID lull.

Regional Indices (NZD) – Trailing Returns (%)



As at 31 March 2024. 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 and also forcing share markets to adjust lower following a very strong run.

We have moderated our expectations around an expected recession to a slowdown and that too may be region and sector specific than widespread. That said, we note a higher risk of escalation in geopolitical tensions as well as a further escalation in the ongoing armed conflicts. Despite the immeasurable loss of life, historically, an escalation of geopolitical tensions or armed conflicts has resulted in short-lived downside for share markets. Accordingly, we believe that any potential pullback in share markets from an escalation of armed conflict may present a buying opportunity for investors.

On the inflation front, we note the progress has been slower than anticipated. Therefore, the recent strong rally of the share markets may have gotten ahead of itself. It should also be noted that central banks may implement loosening of respective policies at different times depending on their outlook on local inflation and economic conditions.

We also believe that corporate profitability may improve over the near term as businesses continue to undertake cost-cutting measures. Profitability may also get a boost from the advent of artificial intelligence. Another observation is that corporate cash positions are elevated, which will allow businesses the opportunity to offer payouts to shareholders or deploy capital to expand.

All in all, we believe that while there may be volatility in the short-term, 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.

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 albeit likely for the short-term.

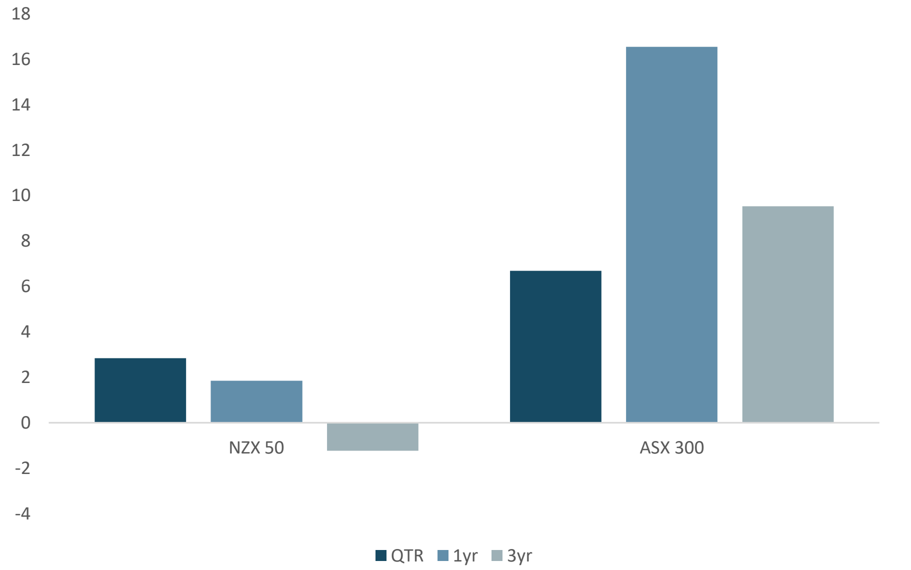
australasian equities

review

The New Zealand share market posted a positive quarter but again underperformed major international share markets. The S&P/NZX50 Index rose by 2.8% for the quarter. Notable outperformer was A2 Milk (51.0%) appreciating on the back of expectations for a recovery in infant formula sales.

Across the Tasman, the Australian share market had a stronger quarter with the S&P/ASX300 Index rising 6.7% for the period. Most sectors had a positive quarter with miners and energy being the relative outperformers for the period.

Australasian Equities (NZD) – Trailing Returns (%)



As at 31 March 2024. 3yr returns are per annum (annualised).

outlook

As per our previous forecasts, New Zealand economy has continued to slow and was deemed to be in a recession again at the end of 2023. Consumers and businesses are still feeling the pinch from the rising cost of living and higher cost of borrowing. While a further 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 due to new migrants filling positions and businesses delaying hiring to manage costs. This has resulted in the unemployment level rising marginally. 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 also expected to see headwinds as global demand stays sluggish.

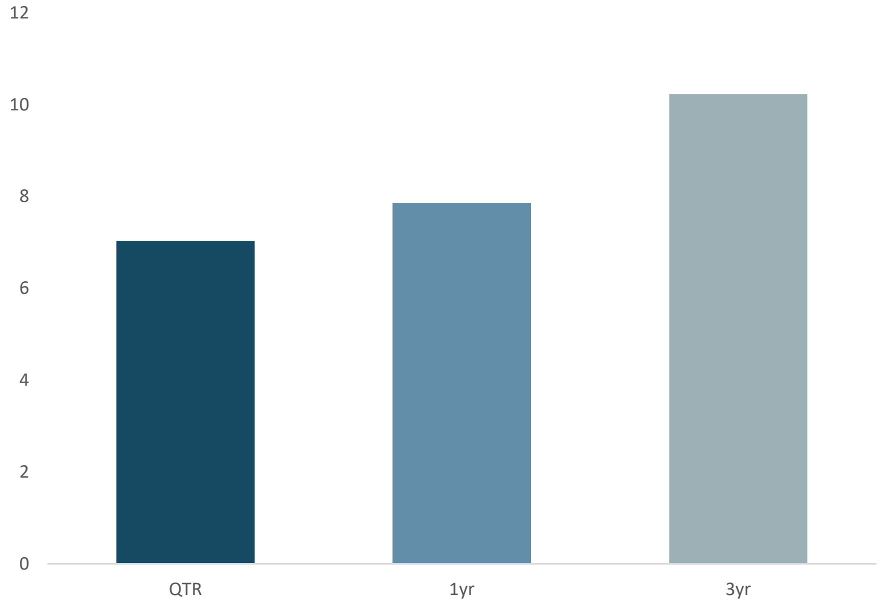
The Australian economy is in a slightly better place than New Zealand simply at not being in a recession (yet). There too, inflation remains much higher than target while consumer spending is slowing due to the impact from high interest rates. We expect the RBA to maintain a restrictive monetary policy stance at least for the near term, which can subdue economic growth further. A silver lining may be China's expansive monetary policy, which may trigger a recovery in imports from Australia.

international infrastructure

review

International infrastructure also participated in the widespread rally with a significantly positive quarter. The S&P Global Infrastructure Index recorded a gain of 7.0% for the period.

International Infrastructure (NZD) – Trailing Returns (%)



As at 31 March 2024. 3yr returns are per annum (annualised).

outlook

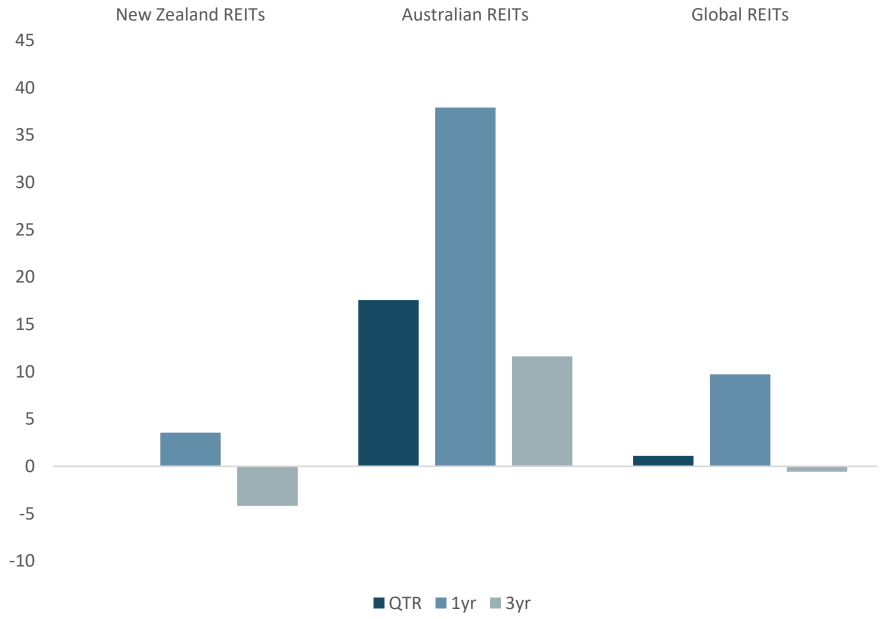
The outlook for international infrastructure as an asset class stays mixed. Airports continue to see healthy aeronautical revenues driven by international travel. However, international travel demand may cool off as consumer discretionary spending continues to slow. Toll roads and bridges should continue to see strong traffic and thereby revenue support. The price of oil has been volatile and may rise if there is a material escalation in any of the armed conflicts. Accordingly, the outlook for energy infrastructure assets appears to be uncertain albeit there will be revenue support if the price of oil rises. Lastly, utilities infrastructure offers investors diversification benefits through a stable dividend yield during heightened volatility in other share market sectors.

property

review

Listed property offered a mixed bag performance as an asset class during the quarter. New Zealand listed property was the worst performing asset class with the NZX All Real Estate Index remaining flat for the quarter while the Australian listed property was the best performer with the S&P/ASX300 A-REITs Index recording a significant gain of 17.6% for the period. International listed property represented by the FTSE EPRA Nareit Index also lagged with a modest return of 1.1% over the quarter.

Listed Property (NZD) – Trailing Returns (%)



As at 31 March 2024. 3yr returns are per annum (annualised).

outlook

As explained in our previous commentaries, a decline in interest rates supports asset valuations, including property. Although yields climbed during the quarter, we maintain that yields will fall over the medium term thereby providing 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 even higher yields and supressed valuations.

Among the subsectors, retail faces the risk of slower consumer spending in New Zealand and Australia as the higher cost of living continues to bite however, retail demand has been persistent overseas. Note that there may be some short-term support for retail 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.

We maintain that the impact of an economic slowdown may become more pronounced in New Zealand over the coming months. A worsening of economic conditions presents a headwind because rental yields may be compromised due to business failures and sluggish lease renewal activity. Accordingly, we favour overseas exposure for listed property over the medium-term.

international fixed interest

review

Bond yields rose across most major economies on the back of heightened geopolitical tensions and threat of an escalation in armed conflicts along with concerns around inflation persisting above target. The US 10-year treasury rate rose from 3.87% to 4.21% during the quarter. The yield on the British 10-year Gilt also inclined materially from 3.54% to 3.95% over the period. Japan's central bank shifted back to credit tightening after being expansive for 17 years. Japan's 10-year yield increased from 0.62% to 0.73% during the quarter. With the rise in yields during the quarter, the Barclays Global Aggregate Index was flat for the period. Although the longer-term return is still unusually negative at 1.6% for the last 3 years due to the aggressive rise in yields over 2022-23, the 12-month return is now a bit more acceptable at 3.8% as a result of the normalisation of yields and a low starting point 12 months ago.

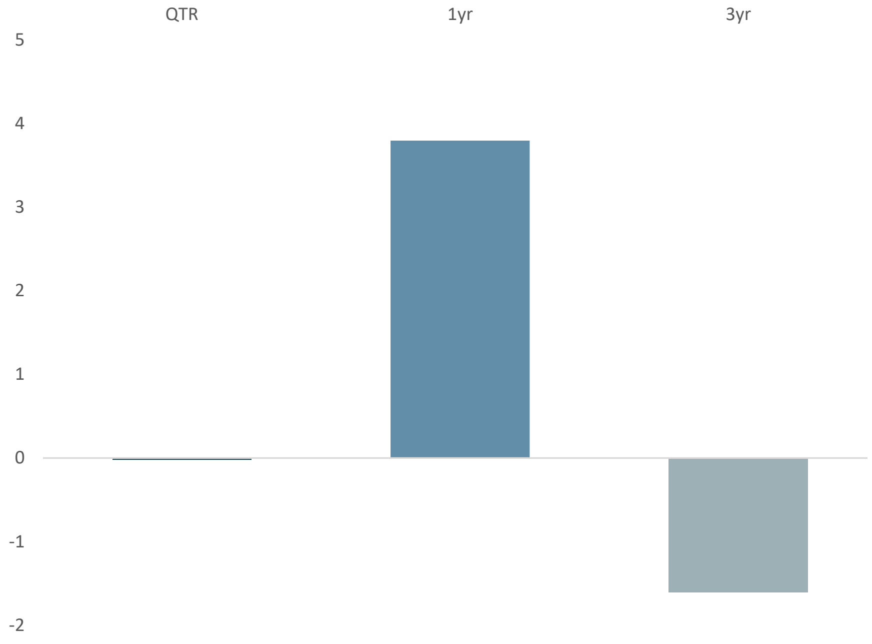
outlook

As per our previous commentaries, we maintain that inflation has peaked, and on the way down. Therefore, most central banks are 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. an escalation in 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.

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



As at 31 March 2024. 3yr returns are per annum (annualised).

new zealand fixed interest and cash

review

The RBNZ maintained its official cash rate at 5.5%. However, the increase in global yields swayed the New Zealand 10-year government bond yield which also rose from 4.39% to 4.61% during the quarter.

The rise in yields resulted in the asset class providing a flat return with the New Zealand Government Bond Index posting a loss of 0.1% for the quarter while the New Zealand A-grade Corporate Bond Index managed a marginal gain of 0.6% 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.

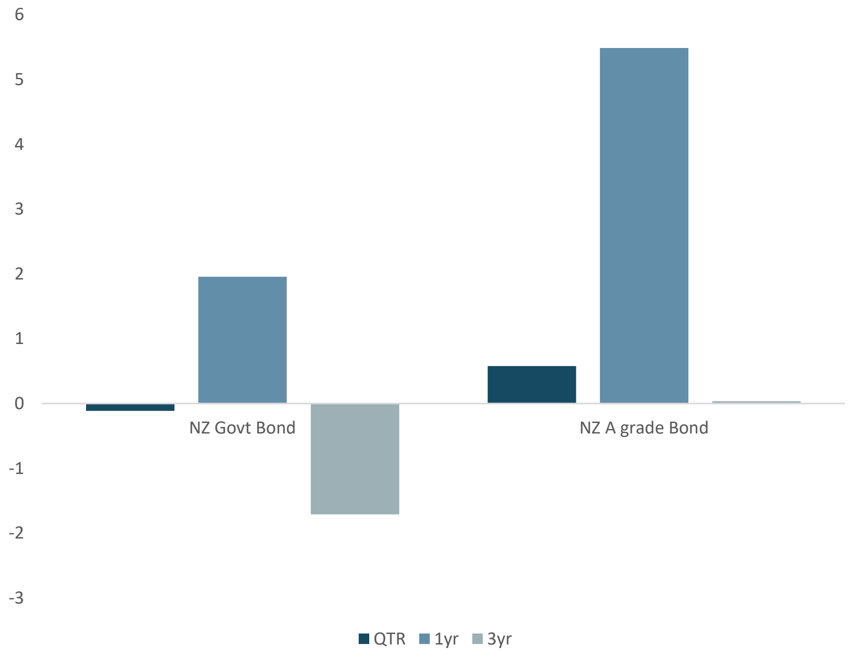
Despite a relatively modest increase in yield, the New Zealand dollar appreciated against the US dollar due to the US Fed's softer tone on policy outlook while the RBNZ maintained its restrictive narrative.

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 (4.0% as at March ’24) 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 March 2024. 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.