Saturn Advice
Creating a richer life

markets summary – June 2024

Asset class	Review	Outlook
International equities	Most share markets had a flat to negative quarter following two strongly positive quarters. This was largely driven by investors taking profits triggered by a temporary escalation of tensions in the Middle East. The US share market managed to record a gain for the quarter while emerging markets outperformed developed markets.	Most central banks are at the cusp of cutting rates. As a result, most economies are likely to experience support over the medium term. 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 is slowing but looks resilient while the European economy is lifting off an economic bottom. Growth in India and Taiwan looks promising while China continues to sputter.
Australasian equities	Both New Zealand and Australian shares had a negative quarter with New Zealand underperforming on a relative basis.	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 may face a relatively restrictive policy stance from the RBA while the lack of growth in the Chinese economy may result in cooling demand for the resources sector.
International infrastructure	International infrastructure was largely flat for 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 had a firmly negative quarter. New Zealand listed property was the worst performing asset class while Australian listed property reported a loss following a strong run over the past year and a bit. International listed property also lagged albeit outperformed on a relative basis.	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 was flat against the US dollar.	The RBNZ has somewhat softened its policy outlook in the wake of declining inflation and rising unemployment. We expect the bond valuations to get support from declining yields as the RBNZ embarks on cutting rates later this year. 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 take a breather from the rally

Most share markets took a breather following two strong quarters, which we had noted as a possibility in our last commentary. While profit-taking was anticipated following the strong returns since late October ’23, the missile exchange between Israel and Iran during April provided the catalyst for a sell-off in the share markets. The sell-off was short-lived as investors bought the dip to provide support to valuations.

Most share markets are still at or near record highs on the back of moderate but sustained economic growth, strong corporate earnings and a lack of new uncertainty on the horizon. While the recent rally was concentrated around the artificial intelligence theme, there are signs the rally may be broadening to other sectors.

During the quarter, the Canadian central bank became the first from the G7 countries to embark on policy easing by cutting interest rates. This was soon followed by the European central bank announcing its first rate cut. The US Fed has also noted the softening job market as a result of its restrictive policy, which may see the central bank proceed with the first rate cut later this year.

A loosening of monetary policy will result in lower interest rates which is supportive of higher asset valuations and will eventually support economic growth over the medium term. This easing policy backdrop should help with broadening of the rally in share markets to sectors that have largely not participated in the strong recent gains.

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

Most equities asset class returns were negative for the quarter. The worst performing asset classes were New Zealand and Australian listed property while Cash was the best performing asset class. Overall, defensive assets outperformed growth assets for the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	1.4	5.8	3.6	2.4
New Zealand Fixed Income	0.7	5.1	-1.5	-0.3
Global Fixed Income	0.1	3.8	-1.9	0.0
New Zealand REITs	-8.7	-8.3	-7.7	-2.8
Australian REITs	-5.2	24.9	6.4	5.6
Global REITs	-1.6	5.5	-3.5	-0.2
Global Infrastructure	0.4	6.5	9.5	5.5
New Zealand Equities	-3.2	-1.7	-2.5	2.2
Australian Equities	-0.7	12.9	6.8	8.2
Global Equities	0.7	20.8	11.8	14.0

Returns are shown as %. 3yr and 5yr returns are per annum (annualised). As at 30 June 2024.

international equities

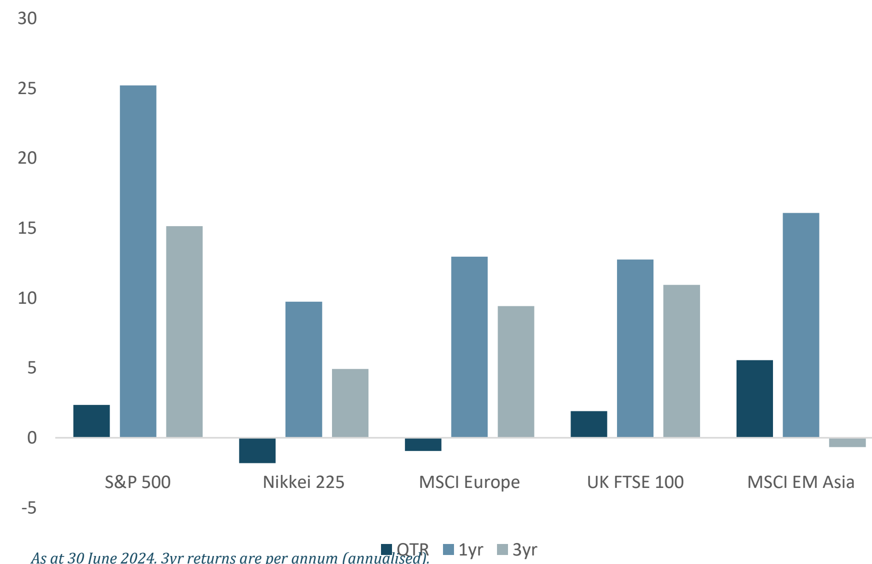
review

As mentioned earlier, most share markets took a breather following two strong quarters. The short escalation between Iran and Israel provided the catalyst, however, investors bought the dip to provide a floor to the sell-off.

For the quarter, the S&P 500 recovered from the April sell-off to record an increase of 2.4% while the MSCI Europe experienced a marginal loss of 0.9%. The Nikkei 225 index declined by 1.8% during the quarter. However, in NZD terms, the loss was significant at 9.3% due to NZD appreciating against the JPY over the period. The FTSE 100 was supported by a rise in commodity prices and returned 1.9% for the quarter.

The emerging markets outperformed the developed markets during the quarter. The MSCI EM Asia recorded a significant increase of 5.6% for the quarter. While some emerging markets like India and Taiwan continued to perform well, the Chinese economy continued to sputter despite government efforts to re-ignite growth with monetary policy support.

Regional Indices (NZD) – Trailing Returns (%)



As at 30 June 2024. 3yr returns are per annum (annualised).

outlook

As previously mentioned, some central banks have already embarked on cutting rates while other central banks are expected to follow suit later this year. This will support asset valuations and also help economic growth over the medium term.

Despite signs of a slowdown appearing for the US economy e.g. a softening job market, we maintain a soft landing as the base case where inflation will be brought under control without tipping the economy into a recession.

The rally in the US share market over the past year or so has been fairly concentrated around a handful companies associated with the artificial intelligence theme. We expect other sectors of the market to drive the rally against the supportive backdrop of declining interest rates. To clarify, we do not anticipate a substantial drop in valuations for the technology sector. However, given the significant increase in technology companies valuations to date, we believe near term earnings growth won't result in a material upside for valuations. We expect the technology sector to maintain valuations while other sectors drive the market forward over the medium term.

We also believe that corporate profitability may continue to 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.

Declining interest rates are particularly favourable for valuations of smaller companies. This is because generally the smaller companies carry higher levels of debt. Therefore, a decline in interest rates will have a more pronounced positive impact on valuations of smaller companies.

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 is slowing but looks resilient while the European economy appears to be lifting of the bottom of its economic cycle. Emerging markets offer a mixed bag with some economies like India and Taiwan expected to grow strongly while the world's second largest economy, China may continue to grapple with sluggish growth. China's housing sector is still a major drag on growth while recent growth in its electric vehicle sector may see headwinds from mounting trade barriers set up by western governments.

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 only likely in the short-term.

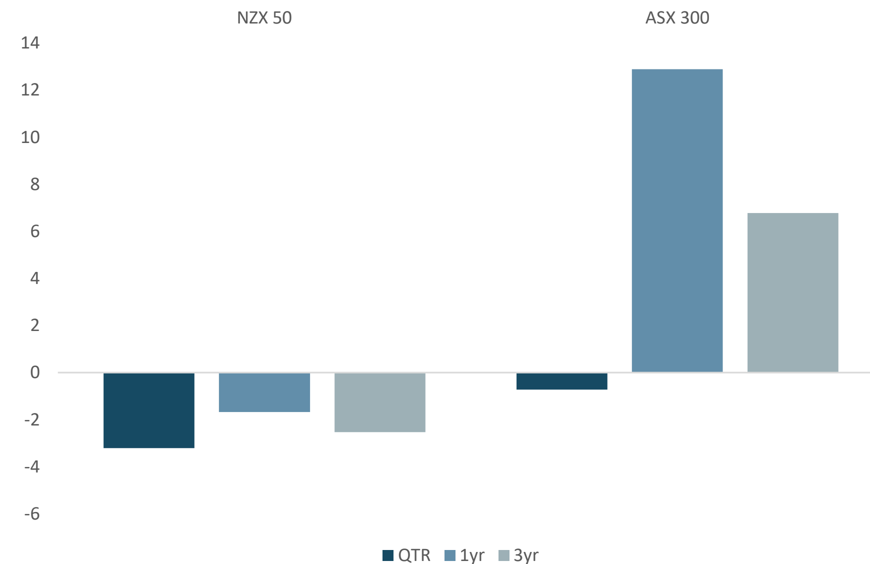
australasian equities

review

The New Zealand share market continued to underperform major international share markets. The S&P/NZX50 Index declined by 3.2% for the quarter. Notable decliners included Tourism holdings (43.7%), Kathmandu (36.4%) and The Warehouse (35.5%). Both THL and KMD declined after cutting their earnings outlook while WHS released a slew of concerning updates including closing its online marketplace, TheMarket.com, after failing to find a buyer and the sudden stepping down of its CEO.

Across the Tasman, the Australian share market also had a negative quarter albeit outperformed New Zealand with the S&P/ASX300 Index registering a marginal loss of 0.7% for the period. Pharmaceuticals and gold miners were the outperformers while the resources sector struggled against the backdrop of a slowing Chinese economy.

Australasian Equities (NZD) – Trailing Returns (%)



As at 30 June 2024. 3yr returns are per annum (annualised).

outlook

While the New Zealand economy technically emerged from a recession with a 0.2% GDP growth for the first quarter of 2024, we believe the economic sluggishness will persist for at least the remainder of the year. Consumers and businesses will continue to feel the pinch from the high cost of living and high cost of borrowing. However, we note some early signs of easing price pressures on some grocery items and mortgage rates also beginning to retreat. The labour market appears to be softening due to new migrants filling positions and businesses delaying hiring to manage costs. This has resulted in the unemployment level rising. We expect the RBNZ to hold the rates at a restrictive level until inflation falls to within the target range with the first cut expected in November 2024. Consequently, our outlook for New Zealand is dull over the near term to moderate improvement over the medium term as interest rates decline.

The Australian economy is in a slightly better place than New Zealand due to the wider spread of sectors. That said, Australia is also dealing with hotter inflation. This has raised stakes of a further rate hike by the RBA when most central banks are at the cusp of

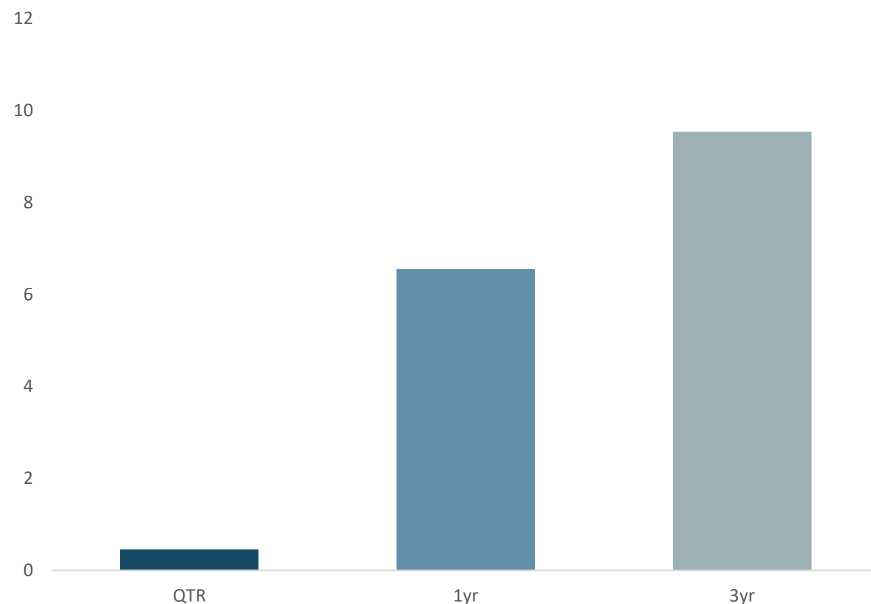
cutting rates. The restrictive monetary policy stance can subdue economic growth. There is further concern from a struggling Chinese economy, which may result in slower demand for the large resources sector. Lastly, the banking sector may benefit from a rate hike by the RBA due to interest margin expansion.

international infrastructure

review

International infrastructure was largely flat for the quarter. The S&P Global Infrastructure Index recorded a gain of 0.4% for the period.

International Infrastructure (NZD) – Trailing Returns (%)



As at 30 June 2024. 3yr returns are per annum (annualised).

outlook

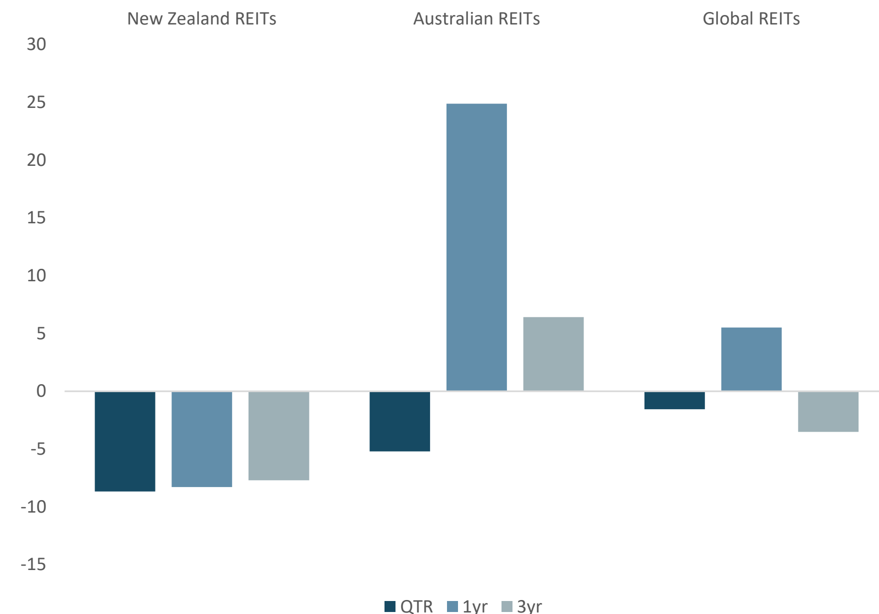
The outlook for international infrastructure as an asset class stays mixed. Airports continue to see healthy aeronautical revenues driven by international travel. However, international travel demand is beginning to cool off as consumer discretionary spending continues to slow. Toll roads and bridges should continue to see strong traffic and thereby revenue support. Short of an escalation in an armed conflict, the price of oil may retreat as voluntary supply cuts by the OPEC+ are unwound over the medium term. 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 had a negative quarter on the back of rising yields. New Zealand listed property was the worst performing asset class with the NZX All Real Estate Index declining by 8.7% while the Australian listed property also registered a significant drop following a very strong rally over the past year. The S&P/ASX300 A-REITs Index recorded a significant loss of 5.2% for the period. International listed property represented by the FTSE EPRA Nareit Index also declined with a modest loss of 1.6% over the quarter.

Listed Property (NZD) – Trailing Returns (%)



As at 30 June 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 high 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 marginally rose across most major economies on the back of heightened geopolitical tensions and threat of an escalation in armed conflicts. The US 10-year treasury rate rose from 4.21% to 4.34% during the quarter. The yield on the British 10-year Gilt also inclined from 3.95% to 4.17% over the period. With Japan's central bank shifting to credit tightening, its 10-year yield increased sharply from 0.73% to 1.05% during the quarter, rising above 1% for the first time since 2011. 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 1.9% 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.

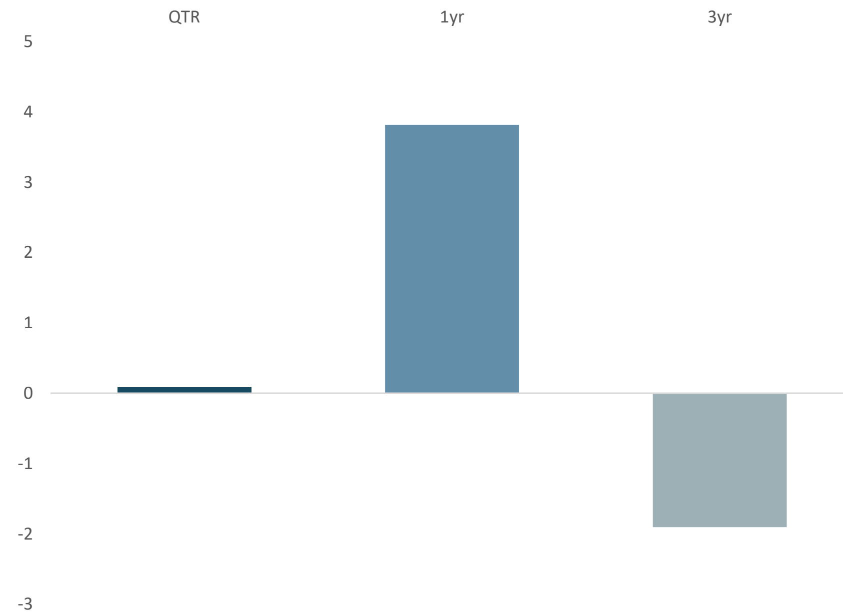
outlook

Most central banks appear at the cusp of cutting rates. 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 30 June 2024. 3yr returns are per annum (annualised).

new zealand fixed interest and cash

review

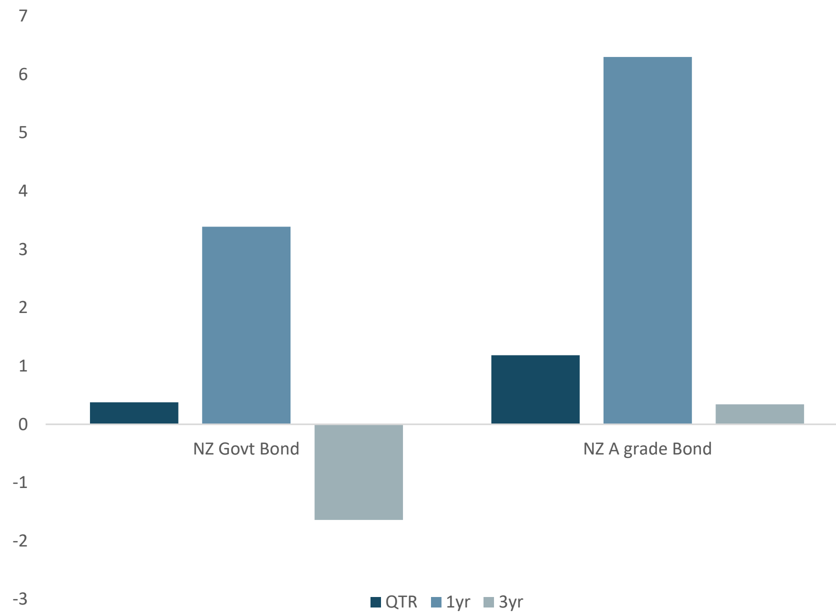
The RBNZ maintained its official cash rate at 5.5%. However, the increase in global yields swayed the New Zealand 10-year government bond yield, which also rose from 4.61% to 4.68% during the quarter.

The rise in yields resulted in the asset class providing a flat return with the New Zealand Government Bond Index posting a gain of 0.4% for the quarter while the New Zealand A-grade Corporate Bond Index managed a gain of 1.2% 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.

With similar increases in respective yields and a somewhat matching outlook for interest rates by the respective central banks, the Kiwi dollar remained flat against the US dollar for the quarter.

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. With labour market softening, unemployment rising and inflation continuing to decline, the RBNZ has slightly softened its outlook for monetary policy. We expect the first cut to be in November this year.



As at 30 June 2024. 3yr returns are per annum (annualised).

In theory, this backdrop should provide support for bond valuations over the medium term. 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.