Saturn Advice
Creating a richer life

markets summary – September 2024

Asset class	Review	Outlook
International equities	Most share markets had a strongly positive quarter following a pivot by most central banks to an easing policy outlook. There was short-term volatility due to unwinding of the Yen carry trade and an escalation of the Middle Eastern conflict. Emerging markets outperformed developed markets.	Most central banks have embarked on 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 strongly positive quarter with New Zealand underperforming on a relative basis.	The outlook for both New Zealand and Australia is for sluggish economic growth. The New Zealand economy should see slow improvement over the medium term on the back of declining interest rates. Australia may continue to face a relatively restrictive policy stance from the RBA due to persistent inflation. Defensive sectors such as telecommunications, healthcare and staples offer value against this backdrop.
International infrastructure	International infrastructure had a significantly positive quarter on the back of declining yields across most major economies, which boosted valuations of infrastructure assets.	The outlook for international infrastructure is positive with supportive macro factors such as declining interest rates and government spending on infrastructure. Utilities infrastructure offers investors diversification benefits with the potential for stable dividend yields to offset heightened share market volatility.
Property	Listed property was the best performing asset class driven by declining yields providing support to property asset valuations. Despite posting a significantly positive return, New Zealand listed property underperformed Australian and International listed property.	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 declined during the quarter on the back of most central banks pivoting to an easing policy stance. Accordingly, the asset class experienced a materially positive return for the quarter.	We maintain our expectations of further declines in 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 cut the OCR in August and again in October while signalling further cuts. Accordingly, the 10-year yield declined for the period resulting in a positive return for the quarter. The New Zealand dollar appreciated against the US dollar over the quarter.	In the wake of declining inflation and rising unemployment, the RBNZ has started cutting rates and has signalled further policy easing. We expect the bond valuations to get support from declining yields. 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.

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world and local economies & markets

the great pivot provides a strong tailwind

Share markets were buoyed by most central banks pivoting their monetary policy stance to easing after more than two years of maintaining a restrictive policy stance. This pivot is primarily credited to inflation declining to manageable levels after spiking in 2022.

July was positive with moderate volatility but August started with a sharp sell-off driven by unwinding of the carry trade in the Japanese Yen. Contrary to most other central banks, the Bank of Japan (BOJ) raised its policy rate above zero for the first time since 2015. The sell-off however, was short-lived as investors focused on fundamentals such as moderate but sustained economic growth, strong corporate earnings and a lack of new uncertainty on the horizon. September started negatively in line with seasonally being a negative month for share markets, this year triggered by heightened geopolitical risks. Again, the sell-off didn't last with share markets recovering after the US Fed announced a 0.5% cut to its official rate while signalling further cuts.

Declining interest rates are supportive of higher asset valuations and will eventually support economic growth over the medium term. This easing policy backdrop should help with further broadening of the rally in share markets to sectors that have largely not participated in the strong gains over the past 18 months.

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.

All asset classes recorded a positive return for the quarter. The best performing asset classes were Listed Property and Global Infrastructure while Cash recorded the lowest return for the quarter. Overall, growth assets outperformed defensive assets for the quarter.

Asset Returns (NZD)

Asset Class	QTR	1yr	3yr	5yr
New Zealand Cash	1.43	5.81	4.02	2.63
New Zealand Fixed Income	3.88	11.58	0.21	-0.10
Global Fixed Income	4.22	10.20	-0.57	0.29
New Zealand REITs	8.45	5.43	-6.16	-2.83
Australian REITs	13.71	48.14	10.29	7.52
Global REITs	12.94	27.12	1.42	0.57
Global Infrastructure	8.41	22.46	11.57	5.66
New Zealand Equities	6.03	9.98	-2.19	2.60
Australian Equities	7.26	23.53	9.60	8.59
Global Equities	1.87	25.06	12.06	12.71

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

international equities

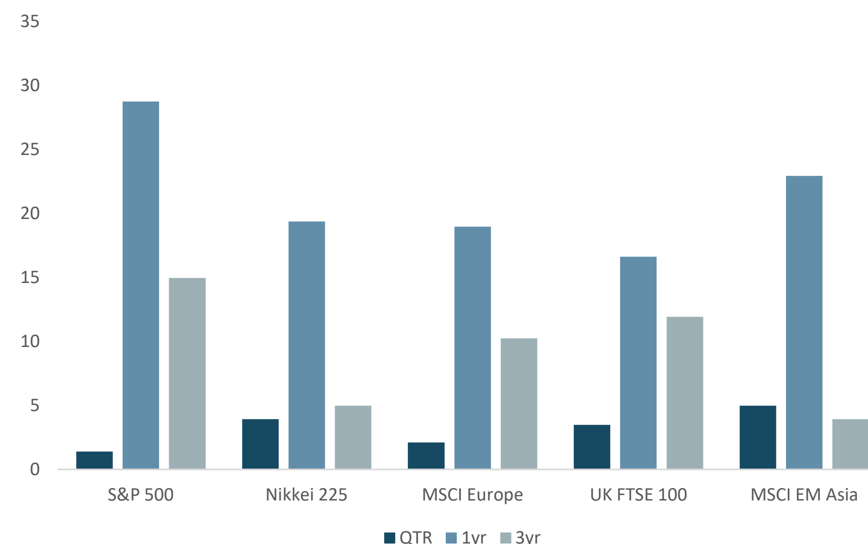
review

As mentioned earlier, most share markets had a positive quarter against the supportive backdrop of declining interest rates while economic growth and corporate earnings appeared resilient. The quarter wasn't without a bout of short-lived volatility from unwinding of the Yen carry trade and an escalation in the Middle Eastern conflict.

For the quarter, the S&P 500 recorded a strong increase of 5.5%, however, in NZD terms its return was moderate at 1.4% for the quarter due to the USD depreciating after the US Fed cut its policy rate aggressively and signalled further cuts. While the Nikkei 225 index declined by 4.2% during the quarter, in NZD terms, the return was positive at 3.9% due to the significant appreciation in the Yen. The MSCI Europe also experienced a positive return of 2.1% for the quarter as ECB eased the policy rates. The FTSE 100 rose by 0.9% during the quarter but the NZD return was higher at 3.5% due to GBP's appreciation as BOE was relatively slow in easing policy.

The emerging markets outperformed the developed markets to register two consecutive quarters of outperformance. The MSCI EM Asia recorded a significant return of 5.0% 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 September 2024. 3yr returns are per annum (annualised).

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outlook

As previously mentioned, most central banks have already embarked on cutting rates while signalling further cuts over the next 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. lower consumer spending, we maintain a soft landing as the base case where inflation will be brought under control without tipping the economy into a deep or prolonged recession.

The rally in the US share market over the past 18 months 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 despite a potential slowing of economic growth, corporate profitability may sustain over the near term as businesses continue to undertake cost-cutting measures. Profitability may also get a boost from the advent of artificial intelligence over the medium term.

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. That said, smaller companies also struggle more during a recession. Therefore, if contrary to our forecast, the US economy undergoes a deep or prolonged recession, smaller companies will underperform.

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 off the bottom of its economic cycle. Emerging markets offer a mixed bag with some economies like India and Taiwan expected to outperform 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.

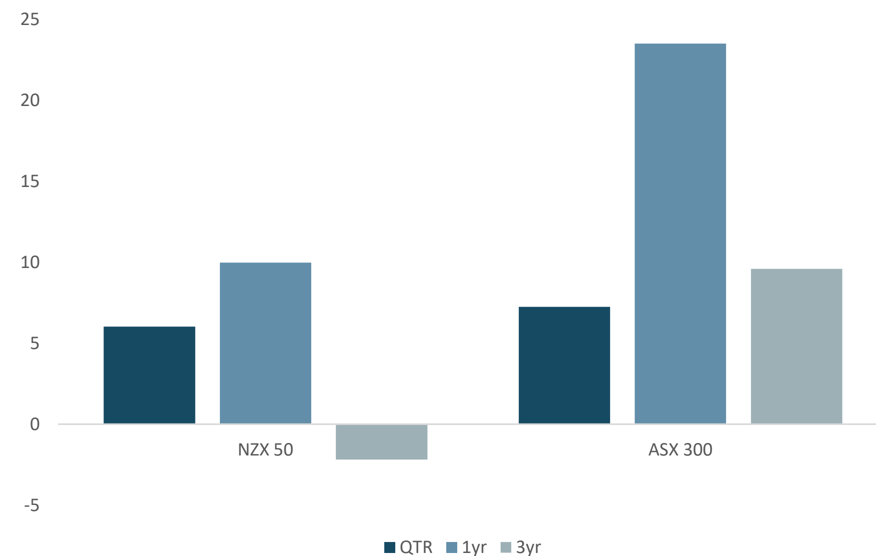
australasian equities

review

The New Zealand share market recorded a strongly positive quarter with the S&P/NZX50 Index rising by 6.0% for the period driven by company-specific news as well as an earlier-than-expected OCR cut by the RBNZ. Notable outperformers included Arvida Group Ltd (79.6%) and KMD Brands Ltd (40.0%). Arvida rose after receiving a takeover offer from US-based real asset investor, Stonepeak at a 65% premium. KMD rose after announcing that its rate of sales decline had slowed in the fourth quarter. This was taken as an indication the company was potentially nearing the bottom of the cycle.

Across the Tasman, the Australian share market also had a strongly positive quarter with the S&P/ASX300 Index registering a gain of 7.3% for the period. Main outperformers included gold miners on the back of rising price of gold while the resources sector outperformed due to optimism that PBOC's stimulatory measures will result in higher demand from China.

Australasian Equities (NZD) – Trailing Returns (%)



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

outlook

The New Zealand economy continues to struggle with the second quarter GDP marginally contracting. We believe the economic sluggishness will persist at least till early 2025. However, we note some early signs of easing price pressures on some grocery items and mortgage rates also continuing to retreat. The labour market appears to be softening due businesses delaying hiring to manage costs and recently high net migration and layoffs making it easier to find workers. This has also resulted in the unemployment level rising. We expect the labour market to remain soft and economic conditions to remain challenging over the near term and to moderately improve over the medium term as interest rates continue to decline.

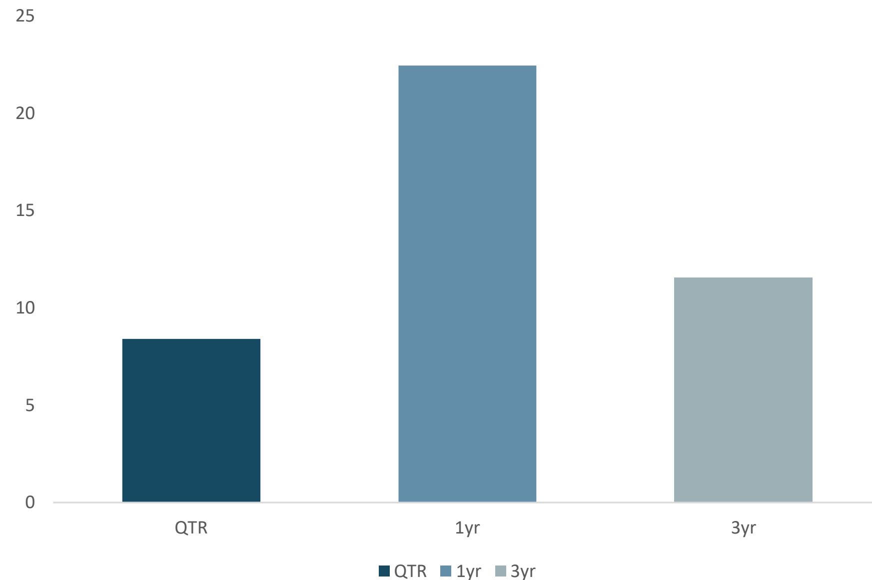
The Australian economy is in a slightly better place than New Zealand due to the wider spread of sectors. That said, Australia is also dealing with comparatively more persistent inflation. This has pushed the RBA to maintain a restrictive policy stance when most central banks have embarked on cutting rates. The restrictive monetary policy stance can subdue economic growth. Defensive sectors such as telecommunications, healthcare and consumer staples offer value against this backdrop. The resources sector may benefit if China's economic growth picks up as a result of stimulatory measures from the PBOC and the Chinese government.

international infrastructure

review

International infrastructure had a significantly positive quarter on back of declining interest rates boosting valuations of infrastructure assets. The S&P Global Infrastructure Index recorded a gain of 8.4% for the period.

International Infrastructure (NZD) – Trailing Returns (%)



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

outlook

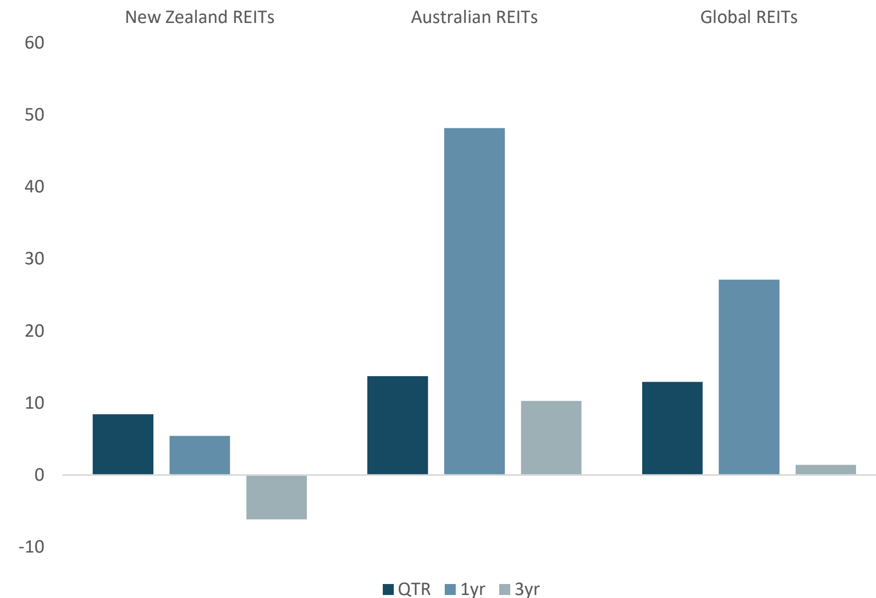
The outlook for international infrastructure as an asset class is positive at the macro level with interest rates across most regions expected to decline over the medium term and governments inclined towards improving existing infrastructure as well as spending on further development. As an asset class, infrastructure is defensive in nature relative to other share market sectors. In particular, utilities infrastructure offers investors diversification benefits through a stable dividend yield during heightened volatility in other share market sectors. Additionally, there is increasing demand for communications infrastructure (e.g. cell towers and data centers), which offer opportunities for growth.

property

review

Listed property was the best performing asset class on the back of the policy pivot from most central banks. New Zealand listed property underperformed on a relative basis despite the NZX All Real Estate Index rising by 8.5% for the quarter. The Australian listed property was the best performer with the S&P/ASX300 A-REITs Index recording a massive gain of 13.7% over the quarter. International listed property represented by the FTSE EPRA Nareit Index was almost in lockstep with Australian listed property with a return of 12.9% for the period.

Listed Property (NZD) – Trailing Returns (%)



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

outlook

As explained in our previous commentaries, a decline in interest rates supports asset valuations, including property. With yields expected to decline further over the medium

term, we maintain that there is 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 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. 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 economic conditions will likely remain sluggish over the near term in New Zealand. Challenging economic conditions may present 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 declined across most major economies as respective central banks pivoted to an easing monetary policy stance. The US 10-year treasury sharply declined from 4.34% to 3.80% during the quarter. The yield on the British 10-year Gilt also declined from 4.17% to 4.0% over the period. Despite Japan's central bank (BOJ) shifting to credit tightening, its 10-year yield decreased from 1.05% to 0.86% during the quarter as heightened geopolitical risks along with BOJ's reaffirmation to its yield curve control pushed the yields lower. With bond yields declining across most major economies, the Barclays Global Aggregate Index was materially positive with a return of 4.2% for the quarter. Although the longer-term return is still unusually negative at 0.6% for the last 3 years due to the aggressive rise in yields over 2022-23, the 12-month return is now looking attractive at 10.2% as a result of the normalisation of yields and a low starting point 12 months ago.

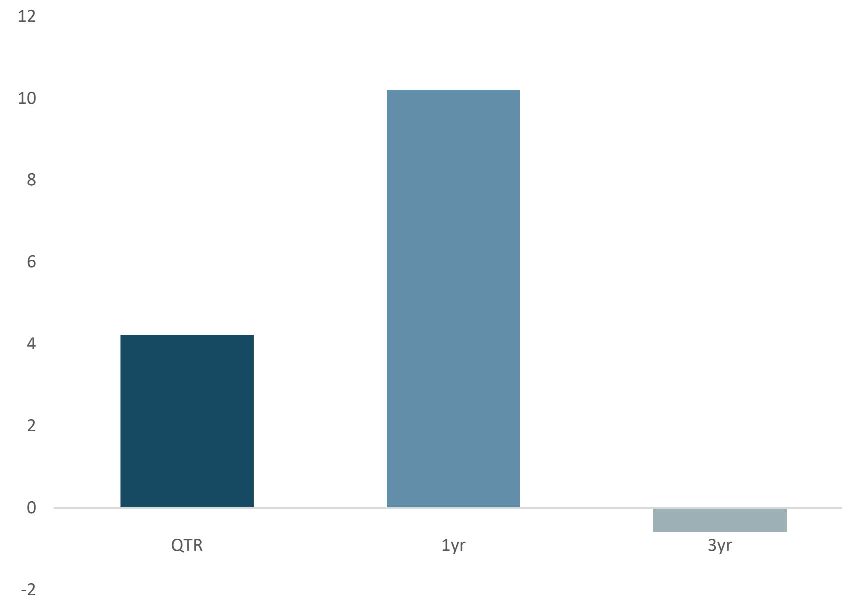
outlook

Most central banks have embarked on cutting rates. We expect yields to decline further 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 September 2024. 3yr returns are per annum (annualised).

new zealand fixed interest and cash

review

The RBNZ made somewhat of a U-turn from its May policy statement and cut its official cash rate by 0.25% in August while signalling more cuts later in the year. Accordingly, the New Zealand 10-year government bond yield declined sharply from 4.68% to 4.27% during the quarter. It is worth mentioning that RBNZ cut the OCR by another 0.5% in October.

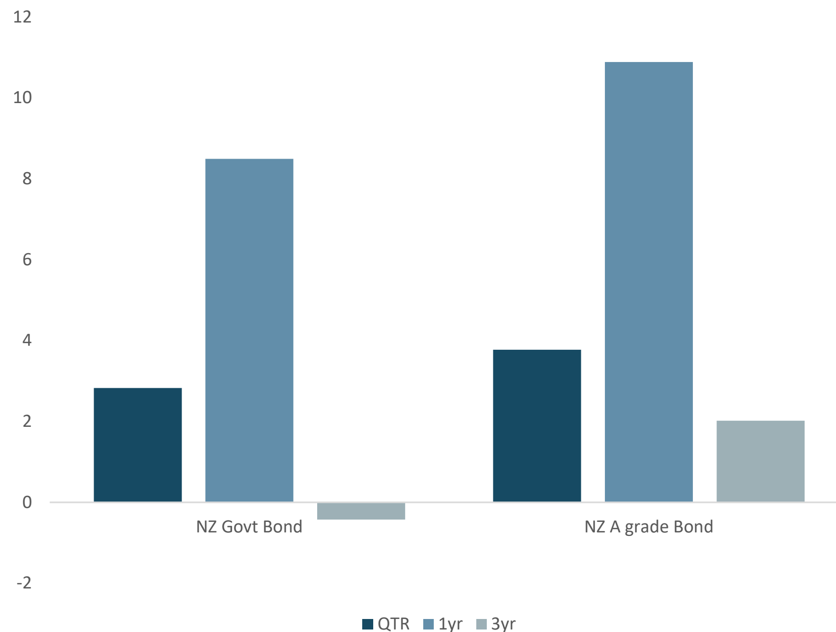
The decline in yields resulted in the asset class providing a materially positive return with the New Zealand Government Bond Index posting a gain of 2.8% for the quarter while the New Zealand A-grade Corporate Bond Index returned 3.8% for the period. Similar to international fixed interest, the 3-year return for New Zealand fixed interest still reflects the impact of aggressive policy tightening by the RBNZ over 2022-23.

Despite similar decreases in respective yields and a somewhat matching outlook for interest rates by the respective central banks, the Kiwi dollar appreciated 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 started to ease its policy with further rate cuts signalled over the near term.

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



As at 30 September 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.