IWIinvestor
Pou Tiaki i Ngā Rawa
New Zealand's wealth advisers

IWIinvestor Investment Report:

Economic & Market Commentary, Quarter End – March 2021

Overview

8.7% p.a.	1.1%	21.6%	7.9%	-3.9%	17	3
Balanced Portfolio 5-year return	Balanced Portfolio 5-years performance versus Peers	Balanced portfolio return over year	Best Performing asset class (Global Eq)	Worst performing asset class (NZ equities)	No. of funds on APL	Funds on watch

Key discussion points

- Most equity markets continued to climb over the March quarter, despite the volatility in interest rates and sell-off in some technology stocks. New Zealand shares were an exception, while fixed income also posted a negative return for the quarter.

- The model portfolios performed very well this quarter, especially the higher risk profiles. Across all risk profiles performance is comfortably ahead of the Peer group we monitor over all horizons. Out-performance over the past quarter and year for the lower risk profiles largely reflects the "tilt" away from duration. Out-performance of the higher risk profiles will likely reflect the SRI focus of the portfolios and cheaper fees than the Peer group average.

- The majority of funds on the APL continue to perform well, only a few funds on watch which are highlighted in this report. This quarter includes some incremental changes to the MyFiduciary fiduciary scoring system (see Appendix for more information), while there have been some changes in the scores the funds on Watch haven't changed.

- The negative quarterly return for fixed income as a warning shot – bond performances could get much worse if markets start pricing in inflationary risks. Building on our previous research provided to you, the accompanying paper to this report provides recommendations for further reducing the portfolio's fixed income risks.

IWIinvestor *Taupō Moana Investments Limited*

PO Box 688, Taupo 3351. Hub @ Totara, 72 Totara Street, Taupo.

Email info@iwiinvestor.co.nz **Website** iwiinvestor.co.nz **Office Phone** 07 378 7644 **Free Phone** 0800 494 468

Financial Market Update

Global equities continued their strong run, only NZ lagging. Fixed income markets suffered a negative quarter.

	3 Months (%)	1 Year (%)
Cash	0.1	0.3
NZ Fixed Income	-2.8	0.1
Global Fixed Income	-2.5	1.4
Global Equities	7.9	30.4
Global Equities - NZD Hedged	6.3	49.6
NZ Equities	-3.9	28.9
Global Listed Property	7.4	30.3
Global Listed Infrastructure	5.7	27.1
Emerging Market Equities	4.0	53.0

The chart shows asset class returns in New Zealand dollars. The underlying indices are shown in the appendix.
Source: Morningstar Direct

Market Commentary

One for the record books

The end of March 2021 marks roughly a year from when Covid-19 became a global pandemic. It is still raging in many parts of the world, and sectors such as tourism remain in the doldrums. Yet equity markets have rallied roughly 50% following the sharp sell-off. The three broad lessons (or reminders) to take from this are:

1. No one has a crystal ball. A large part of the reason markets are higher today is because economic conditions and earnings were not hit anywhere near as hard as predicted. In New Zealand, the Treasury predicted GDP would shrink over 10% in 2020 - it fell around 2%. Businesses proved much more resilient at coping with the 'shock', and the massive fiscal and monetary policy support measures put in place also played a key role in propping up demand and employment.

2. Markets are forward-looking. The very large decline in February 2020 reflected concerns around how the pandemic would impact growth and earnings. Markets rallied from around April 2020 as it became clearer that the shock to economic conditions would not be as large as feared, and that some sectors, such as health and tech, would thrive. More recently, value and cyclically sensitive stocks (even airlines!) have started to out-perform. Markets are now pricing in the fact that with vaccination programs well under-way in much of the industrialised world (NZ and Australia excepted) it won't be too long before we see earnings for affected corporates recover too.

3. It pays to be contrarian. Investors who took the opportunity to at least rebalance portfolios in response to last-year's sell-off (by selling bonds to buy equities) experienced better returns than investors who sat on the fence, or even worse, de-risked and effectively locked in losses.

Our advice in March 2020 was that we didn't know whether the lows had been seen but we remained confident that the long-term reward for bearing market risk remained intact. The 'shock' would pass, and rebalancing remained the best course.

We have not changed our stance subsequently, although we do now expect returns, post such a strong rebound in markets, to be much lower going forward. We also see very little reward for bearing interest rate (long duration) risk and have been positioning your portfolios to reduce their interest rate sensitivity.

Market roundup

International shares rose around 8% in the quarter in NZD terms, whilst NZD hedged shares increased around 6.3%. These results were sufficient to propel global markets to new highs and represent spectacular double digit returns for the year ended March 2021 (see figure 1) – although it should be noted that returns are flattered by the fact that we are starting from near-Covid lows.

Within global equities, higher risk small and value stocks outperformed in the quarter, both returning around 11% in NZD terms. Emerging Market and Australian equities also performed well, increasing over 5% in NZD terms. In contrast, New Zealand shares fell around 4% in the quarter. That said, their returns were still very strong at around 29% for the year ended March 2021.

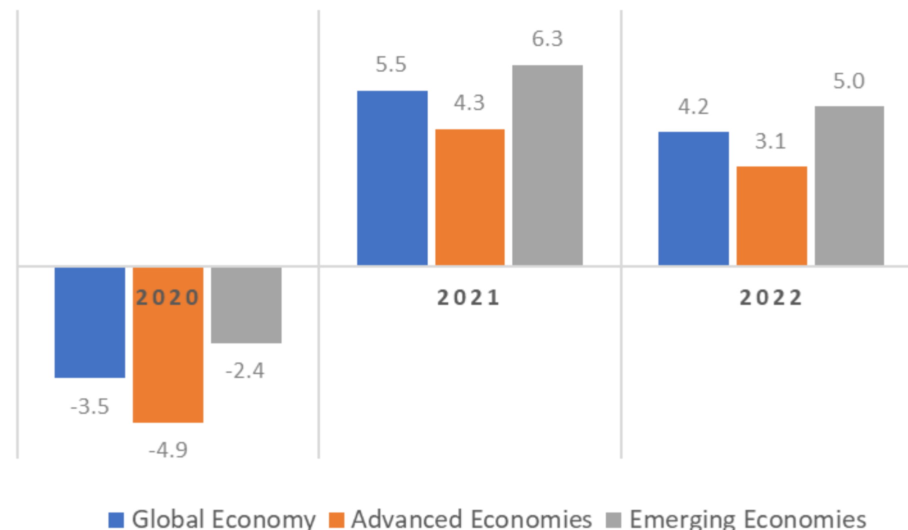
International property stocks rose by around 7.5% in the quarter and are up 30% over the year to March 2021. This brings the level to around 10% lower than was the case pre-Covid. International infrastructure has been more resilient, with returns broadly flat since before Covid struck.

Fixed income had negative returns over Q1. New Zealand investment grade (IG) bonds fell around 2.8% in the quarter, with government bonds declining around 3.5% and corporate bonds 2%. International investment grade bonds also declined, by around 2.5%. Over the year their returns were just 1.5%. These outcomes are the flip-side of what has happened with growth assets.

Looking Forward

Economic agencies, with appropriate caveats and the usual handwringing, are predicting exceptionally strong growth over the next few years as mass inoculations roll-out and life normalises. The IMF estimates that global GDP fell 3.5% in 2020 but will expand 5.5% this year and 4.2% in 2022. US growth, which is being turbo-charged by high fiscal and infrastructure spending, is expected to increase 6.4%. Investment bank Goldman Sachs goes further, predicting US GDP growth to rise 8%. To put these numbers in perspective, if realised it would be the strongest growth in generations, and at the global level, the strongest growth since the recovery from WWII! Closer to home, the RBNZ predicts growth to be around 4% in 2021 and the BNZ forecasts over 5%.

It's easy to be sceptical. Economic agencies were far too pessimistic last year and may now prove to be too optimistic. However, most forecast errors made by agencies typically result from their being too conservative, particularly around recoveries. Time will tell.



SOURCE: IMF

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