Overview

4.12% p.a.	xx%	7.16%	7.5%	-0.4%	21	2
Balanced Portfolio 5-year return	Balanced Portfolio 5-year performance versus peers (per annum)	Balanced portfolio return over year	Best Performing asset class: quarter (Global Equities)	Worst quarterly performing asset class: quarter (NZ Fixed Income)	No. of funds on APL	Funds on watch (-1)

Key discussion points

- Markets climbed higher over the June quarter, led by the tech sector. Global equities had the strongest returns, elsewhere performances were subdued. Global equities are now back around the peaks reached in 2021, but NZ equities and bonds still have ground to make up.
- All model portfolio returns were positive this quarter, with most models also outperforming their respective peer group averages over the quarter and horizons from one to five years. This mainly reflects the asset allocation choices taken. The only exception is a slight under-performance of the growth risk profile at a one -year horizon.
- The majority of funds on the APL continue to perform well, with Dimensional Emerging Markets Sustainability and Kernel Global Infrastructure on Watch due to its short history.
- As part of our ongoing commitment to assessing the impact of climate risk in your portfolio we have provided a summary of the funds with a low-carbon focus in your portfolio and extended our greenhouse gas emissions analysis across the total growth exposure (shares, property and infrastructure). This analysis shows a material reduction in the greenhouse gas emissions of your portfolio versus a benchmark.

Recommendations

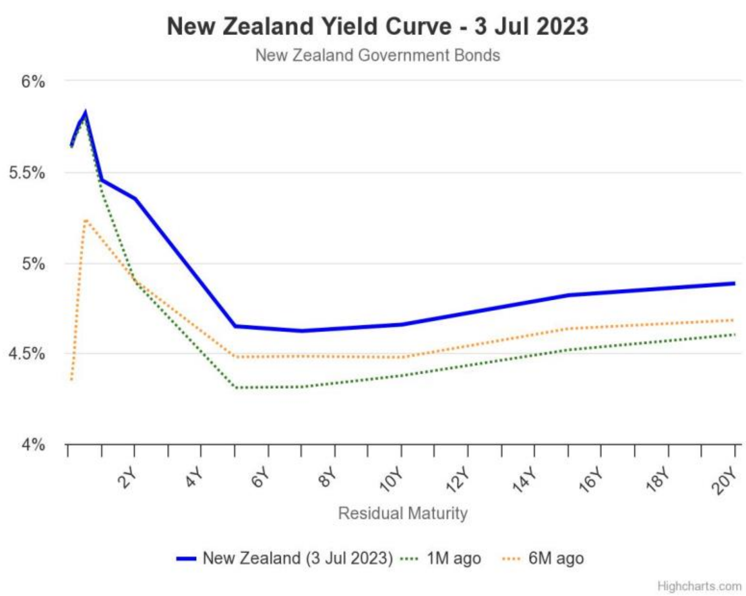
- No recommendations this quarter

Market Commentary June Quarter 2023

Overview

Global equity markets bounced higher again in the June quarter. This was in part due to continued evidence of CPI inflation moderating, but mainly because larger cap tech stocks rallied on the prospect that they will see another surge in profitability as machine learning and related 'AI' algorithms are integrated into their core products and services.

Figure 1: Bond markets think the RBNZ has done more than enough



Source: Highcharts.com

International shares rallied strongly, by around 7.5% in the June quarter, but elsewhere performances were more subdued. Australian and emerging market equities and global listed property increased a little over 1%, NZ equities rose around 0.5%, while bonds were flat to slightly declining, as was global infrastructure.

Over the year to June, performances are very strong for most equity markets, with global equities in NZD terms leading the pack being up 22%. This gain more than offset the decline over 2022. However, in part this reflects that the NZ dollar also plummeted over 2022, and has not bounced back nearly as much. On a local currency basis global equities are still slightly below the peak levels they had at the end of 2021.

In contrast to global equites, NZ equities are still around 11% lower than their 2021 peak levels. Bonds have a similar amount of ground to recover given the large declines they suffered in 2022. The good news in this regard is that with cash yields now around 6% for investment grade funds, and with inflation trending lower we can expect this ground to be made up over the next year or two assuming that the macroeconomic picture evolves broadly in line with what is expected.

Market Commentary June Quarter 2023

Reading the tea leaves

There is now little doubt that inflation rates and economic activity are declining both in New Zealand and globally. This is welcome news for central bankers trying to return inflation back to target levels, but cold comfort for almost everyone else. The key question is whether they have done enough?

Bond markets seem to think so. Yield curves are inverted, meaning that short-term interest rates are higher than expectations of future short-term rates. This is shown in Figure 1 for New Zealand, which is expected to be amongst the first countries to start cutting. Interest rates in one year's time are expected to be around 0.5% lower, and in 5 years' time over 1% lower. But bond markets, like macro-economists, are not great at forecasting. The chart also shows that the curve has jumped from its level just one month ago. This reflects that although inflation is coming down, 'core' inflation rates are still too high for central banks to declare victory just yet, and hence interest rates may need to stay higher for longer. Time will tell.

There is plenty to be concerned about geopolitically but to end on a potentially positive note, artificial intelligence ('AI') does present a large potential upside to economic growth and productivity levels. Goldman Sachs estimates that AI could lift global productivity by 15% over the next decade – a simply enormous gain. While we should treat these estimates with a healthy grain of salt, it is also worth remembering that ultimately productivity is most of what propels living standards and equity markets higher. As uncomfortable as they are at the time, interest rate cycles and most other 'shocks' just cause blips along the way.

The Quality Factor

Along with exposure to small and value factors, in some funds, we also have exposure to the so-called 'quality' factor.

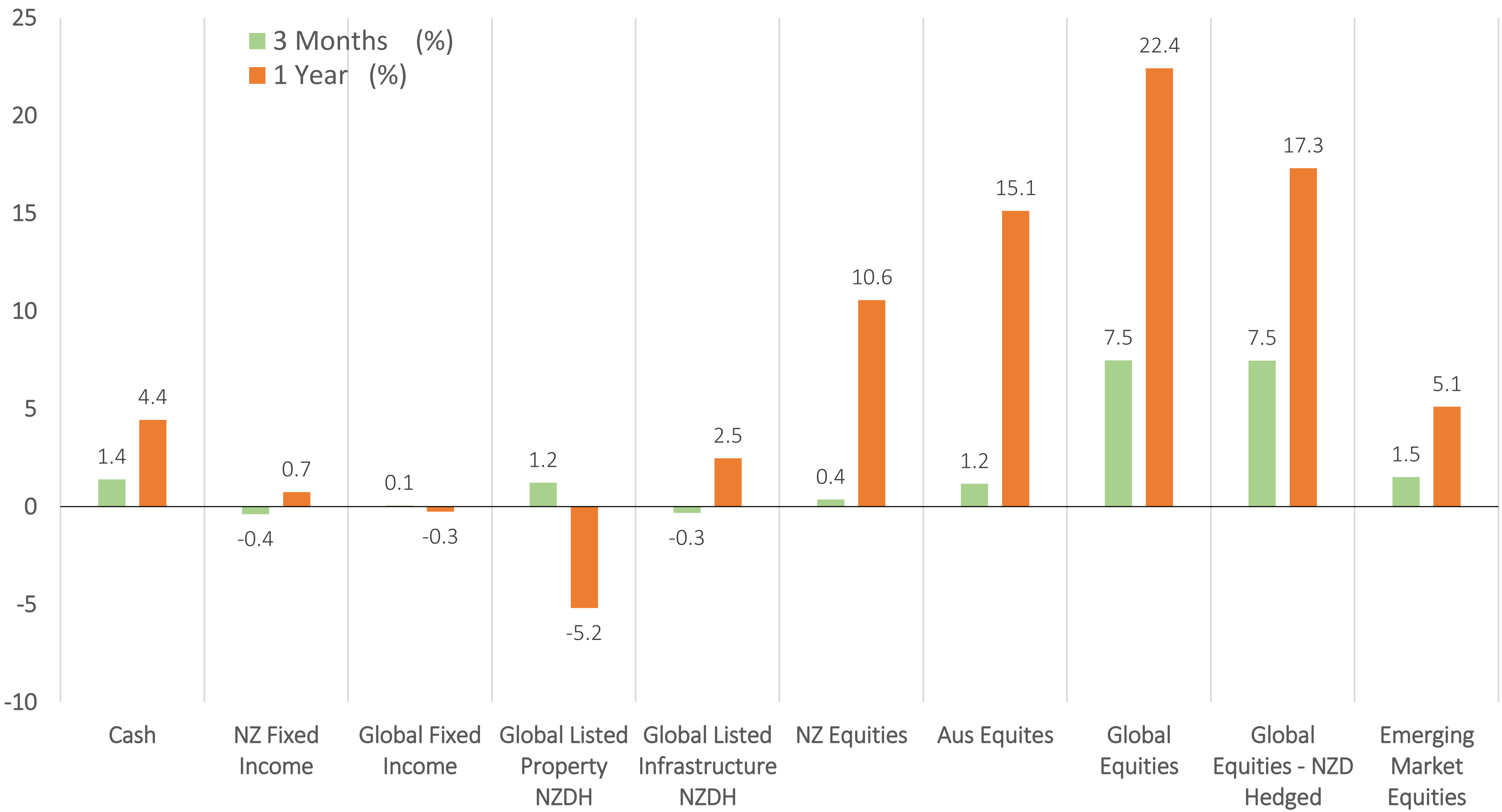
A listed company is judged to be high quality if some combination of its profitability, after tax cash-flows, balance sheet strength, earnings and dividend history, and governance are better than market averages. In essence, a quality company is more likely to be profitable over an economic cycle, and less prone to suffer stress in a recession, than the 'average' company.

Intuitively it is reasonable to think that higher quality stocks should outperform lower quality stocks in times of stress. But given this, we might think this advantage is "priced in" and as such there is no long-term premium or extra return from investing in the quality factor. Academic studies, however, suggest this is not the case. Quality companies are estimated to outperform lower quality companies by around 1-3% per annum on average across global equity markets. In 2022, a study of quality ETFs found that they outperformed the market on average by 2.3%, in line with longer-term academic estimates. Quality stocks also handily outperformed over calendar 2022.

While we have no funds dedicated to capturing the quality factor in isolation in our portfolios, several equity funds include quality as a factor, alongside other factors that the manager targets. In particular, Dimensional includes the quality factor in its global core and small-cap funds. This inclusion is consistent with a *multi-factor* approach to capturing factors, which reduces the risk of any single factor not delivering in any given year. Over calendar 2022 when global equities fell around 11.5% in NZD terms this was put to the test. Dimensional Global Core and Global Small both outperformed global equities (MSCI World basis) by 3.7%, handily cushioning the large fall in markets.

Financial market update

Markets other than global equities were quiet over the quarter.



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

MyFiduciary
Governance & Investment Support

Important information