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

IWIinvestor Investment Report:

Economic & Market Commentary, Quarter End – December 2021

Overview

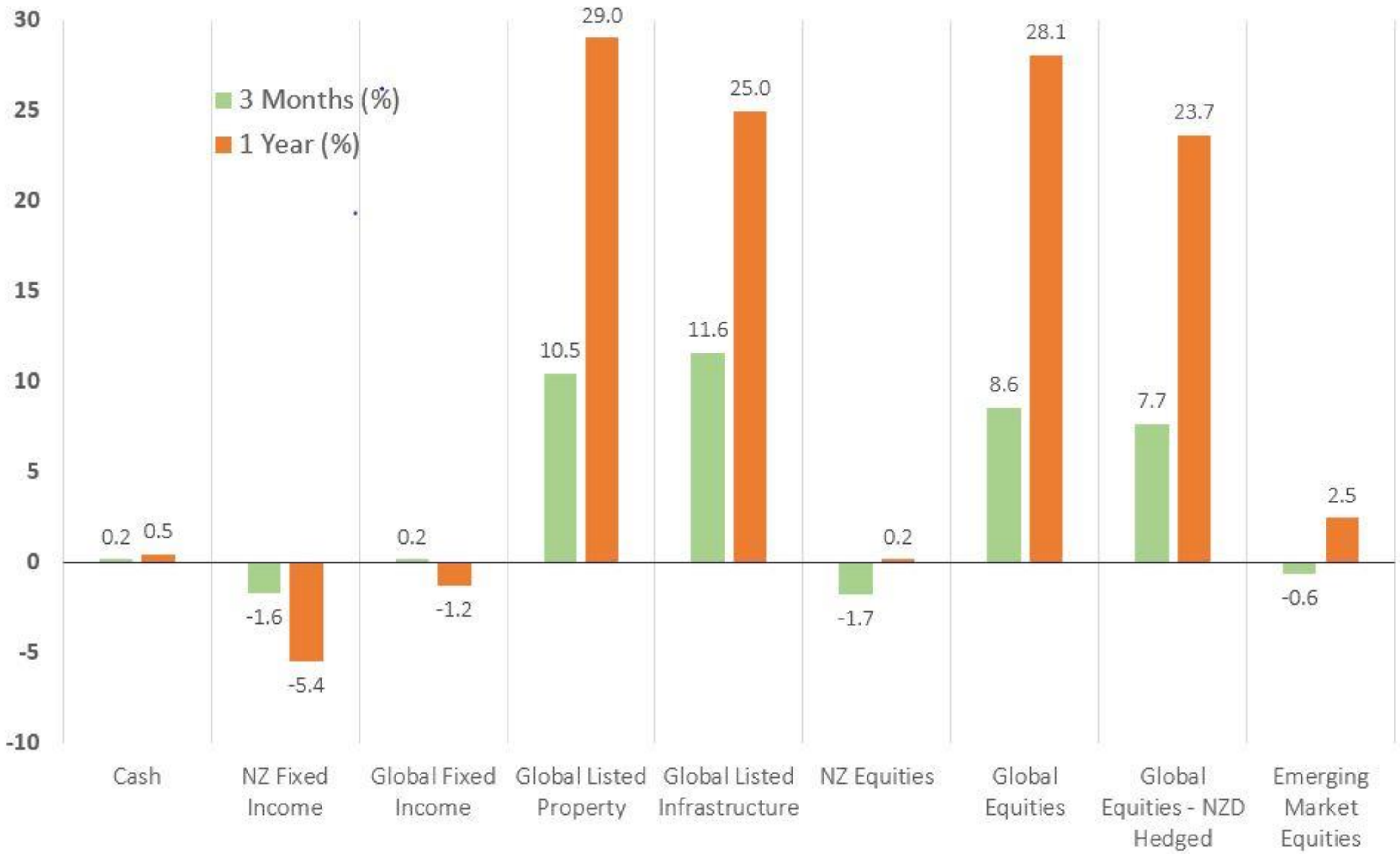
9.3% p.a.	+1.5%	10.5%	11.6%	-1.7%	20	2
Balanced Portfolio 5-year return	Balanced Portfolio 5-year performance versus peers (per annum)	Balanced portfolio return over year	Best Performing asset class: quarter (Global Infra)	Worst quarterly performing asset class: quarter (NZ equities)	No. of funds on APL	Funds on watch

Key discussion points

- Returns were mixed over the quarter with poor returns from fixed income but very strong returns from property and infrastructure.
- The model portfolios were well ahead of peer group for the quarter, extending the lead over 1, 3 and 5 –year horizons. For lower risk profiles the duration tilt is the main reason for this out-performance, while for the higher risk profiles the relatively large allocation to real assets, and lack of allocation to "growth" stocks, are likely the main contributors. Given the massive under-performance of tech and growth stock so far in 2022 we would expect this out-performance to increase, all else equal, at the next quarterly update.
- The majority of funds on the APL continue to perform well, with the only two funds on watch (Dimensional 2-Yr Fixed Interest and Kernel Global Infrastructure) being due to their short history.
- We have updated analysis on the carbon emissions from your global equity SRI allocation in line with the BlackRock fund changes. This shows a large reduction in the overall emissions from the underlying global managers you invest with.

Financial Market Update

Growth assets – equities, property and infrastructure – are driving returns



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

Market Commentary

Rising inflation and diverging macro-economic trends have led to mixed returns for the quarter

Overview

- Market performances were mixed in the December quarter. Global equities, listed property and infrastructure had very strong returns. Emerging market equities treaded water. Global and NZ bonds again performed poorly, and New Zealand equities were negative.

- Rising inflation and the prospect of central banks increasing interest rates weighed down fixed income (and the NZ share market) but provided strong support to listed infrastructure, property and gold.

- Solid corporate earnings and strong growth conditions remain in place for many global corporates. EM equities were held back by lingering concerns around Chinese risks; however, we continue to believe long-term investors will be rewarded here.

Market Roundup

Developed market equities climbed further over the December quarter, by around 8.5% in NZD terms. This resulted in an annual return of 28%, while NZD hedged shares increased around 24%. Within global equities, higher-risk small caps had a weaker annual return (18.5%) while value stocks performed in line with the market.

Emerging markets had a softer quarter, falling by around 0.5%. This reflected ongoing geopolitical tensions with China and concerns around the surprisingly heavy-handed approach that the Chinese authorities have taken to rein in “excess profits” in its tech sector and related listed companies such as Alibaba and Tencent. That said, Chinese growth has remained relatively firm and concerns that property developer Evergrande’s failure will severely dent overall growth have dissipated. Australian equities reflected this diminished risk, increasing around 3.5% in the quarter and have returned 17% over the year.

International infrastructure and property stocks had a very strong quarter. International property rose 10.5% in the quarter and around 30% for calendar 2021. International infrastructure returned around 11.5% in the quarter and 25% over the year. Both of these asset classes have benefited from rising inflation and inflation risks.

On the flip-side, bonds are less resilient to rising inflation and interest rates. As a consequence, New Zealand investment grade (IG) bonds fell 1.4% in the quarter and 4.2% over the year. International IG bonds fared a little better, being flat in the quarter and falling around 1.4% over the year.

Outlook for the years ahead

We do not have a crystal ball to predict what will happen to markets in the months ahead – of course nobody does. But we have recently updated our long-term asset class expected return forecasts, in which we take into consideration the very strong returns from growth assets over the past 5 years and more, and the exit we are now seeing from ultra-supportive monetary policy and interest rate levels.

Our forward-looking expected returns are provided in the following table, alongside a forecast range from industry "experts" including global asset managers, investment organisations and consultants.

Key points are that:

- We expect returns for most asset classes to be lower than they have been than over the past decade.

- We expect to see cash rates continue to lift towards levels that are higher than today but still quite moderate compared to longer term history.

- We expect to see equities and other growth assets offer a premium (higher return) to cash over the long term. This is in line with the majority of experts and long-term financial history which suggest it is both rare and fleeting to see equity markets under-performing cash over two- or three-decade time horizons.

- We expect bonds to offer only a very modest excess return to cash, and there is a chance that this may be negative over a more medium-term time horizon. This reflects that while we think cash rates are heading higher over the next few years or so, markets are yet to fully factor this into bond prices. For this reason, your portfolios have materially reduced their exposure to bond funds with relatively "standard" maturity terms (or duration) in favour of bonds and related instruments with relatively short duration.

- We expect reasonable returns from listed property, infrastructure and "alternative" assets.

As always, we can point to a laundry list of risks that may present challenges to markets at some stage: the ongoing pandemic, supply-chain issues, rising inflation and interest rates, geopolitical tensions, huge national debt levels, over-priced housing markets, etc. We can also point to the fact that global growth has remained robust through the stops-and-starts to activity, and should the current Omicron wave mark an end to the pandemic, growth should bounce higher still.

Whatever transpires in markets we are confident that your portfolios are well-designed to manage inflation and other risks, and that they will continue to offer a better return than cash over the medium to longer term.

MyFiduciary's long-term expected returns

Asset Class	Expected long-term return
NZ Cash	3.5%
NZ Bonds	4.0%
Global Bonds	3.7%
NZ equities	7.4%
Australian equities	7.6%
Global equities hedged	7.5%
Emerging market equities	9.2%
Global listed property	6.2%
Global listed infrastructure	6.2%

Source: MyFiduciary

Disclosure:
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