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

IWIinvestor Investment Report:

Economic & Market Commentary, Quarter End – June 2021

Overview

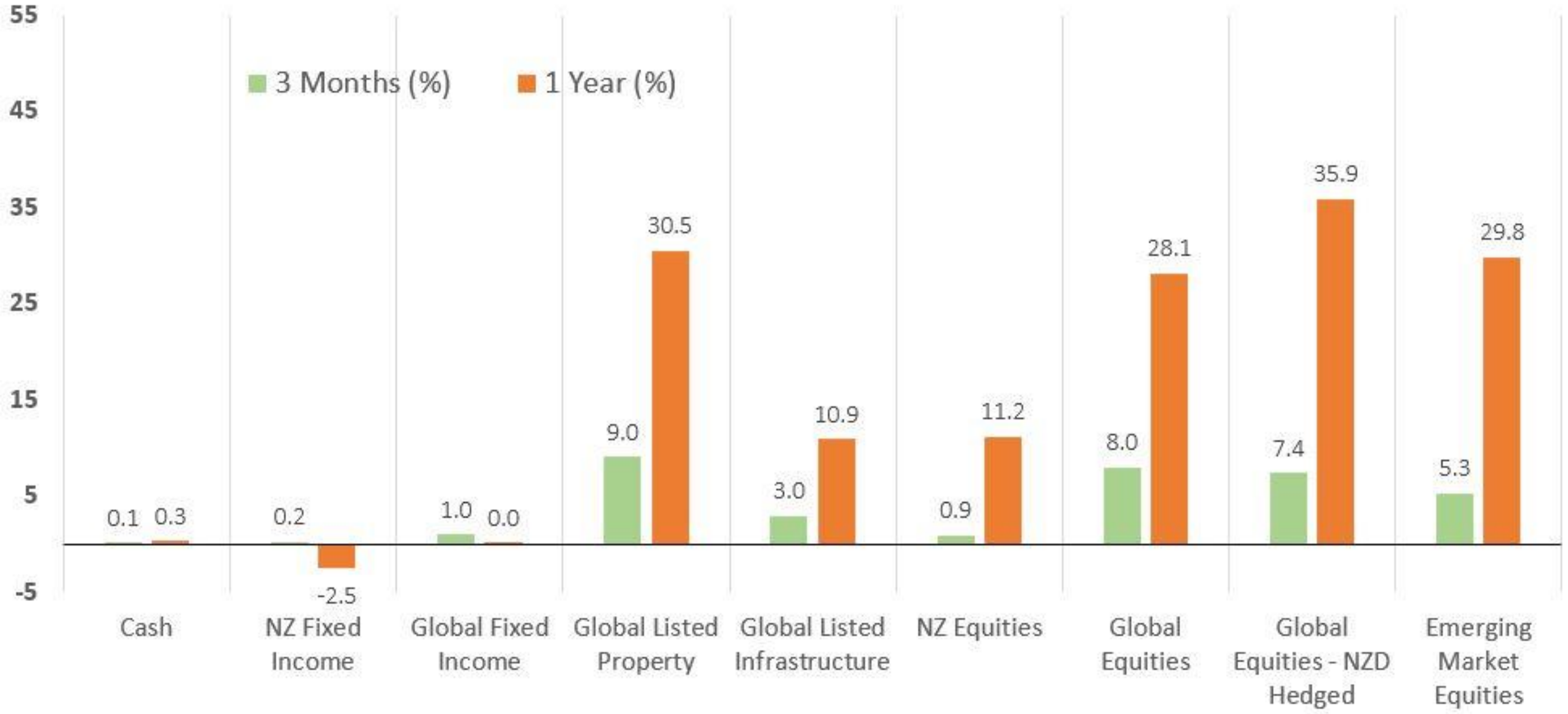
9.3% p.a.	+1.2%	16.1%	9.0%	0.0%	17	2
Balanced Portfolio 5-year return	Balanced Portfolio 5-years performance versus peers (per annum)	Balanced portfolio return over year	Best Performing asset class: quarter (Global REITs)	Worst quarterly performing asset class: quarter (NZ Cash)	No. of funds on APL	Funds on watch

Key discussion points

- Equity markets continued to climb over the June quarter, while fixed income returns were weak.
- The model portfolios performed well, 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, with the only two funds on watch (Daintree High Income and Kernel Global Infrastructure) being due to their short history.
- Please note that this update does not report the recently approved changes to the model portfolios, and the three new alternative funds as part of this. We are working with FNZ to load two of the new alternative funds onto the platform (the Gold ETF is on the platform). We expect the new funds to be available for investment shortly, and the next quarterly update will contain reporting on the new funds. Please let us know also when you would also like to see reporting on the portfolios given your client transition pacing.

Financial Market Update

Global equities continued higher with NZ lagging. Fixed income flat to negative over 12 months.



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

Market Commentary

Most equity markets continued to climb over the June quarter, extending their record highs. Robust economic growth, vaccine roll outs and ongoing or newly promised stimulus programmes far outweighed concerns around resurgent Covid cases and lock-downs in some countries. However, it wasn't plain sailing across all asset classes. Fixed income returns were again weak as cost pressures and inflation risk concerns continued to mount. This is clearest in New Zealand where there has been a complete U-turn in the RBNZ's outlook for interest rates – from cutting rates to increasing them possibly as soon as August.

Market Roundup

Equity markets are now clearly higher than before the Covid pandemic. International shares rose 8% in the quarter in NZD terms and 28% for the year to June. NZD hedged shares increased around 7.5% in the quarter, and over 35% for the year.

Within global equities, higher-risk small and value stocks mildly under-performed in the quarter, returning around 5% in NZD terms. Over the year, however, global small caps out-performed returning over 40% and value stocks performed in line with the market overall. Emerging Market and Australian equities also performed well, with both up close to 30% for the year to June.

In contrast, New Zealand shares only returned 0.9% in the quarter and are up around 11% for the year to June 2021. Their performance has slipped to now be slightly below global market returns over the past three and five years. This illustrates the importance of diversification within equity market holdings, and that we shouldn't expect a single market to continue to outperform.

International infrastructure rose 3% in the quarter while international property stocks increased by around 9%. On an annual basis returns were around 11% and 30% respectively. Concern that Covid would permanently reduce tenancy demand has waned for the property sector overall, with sub-sectors such as industrial property bouncing on the back of very strong manufacturing activity and low vacancy levels.

Fixed income posted small positive returns over the June quarter. New Zealand investment grade bonds rose around 0.3%, resulting in an annual performance of -1%. International investment grade bonds have fared a little better, increasing by around 1% in the quarter with flat performance over the past year.

New Zealand is expected to tighten interest rates first

In our last update we highlighted that most forecasters are predicting growth over the next few years to be at multi-decade highs as life "gets back to normal" and as fiscal spending programmes turbocharge growth. Actual data outturns over the June quarter have been broadly in line with this theme. Global manufacturing activity is firmly in expansionary mode, unemployment rates continue to fall, and consumer spending is booming. In NZ, GDP in the March quarter rose 1.6%, well ahead of most forecasters' expectations and firmly putting to rest any concern that our economy might experience a real recession. Annual CPI inflation for the June quarter was 3.3%, well ahead of market expectations and the highest rate in over a decade (abstracting from the GST increase in 2010).

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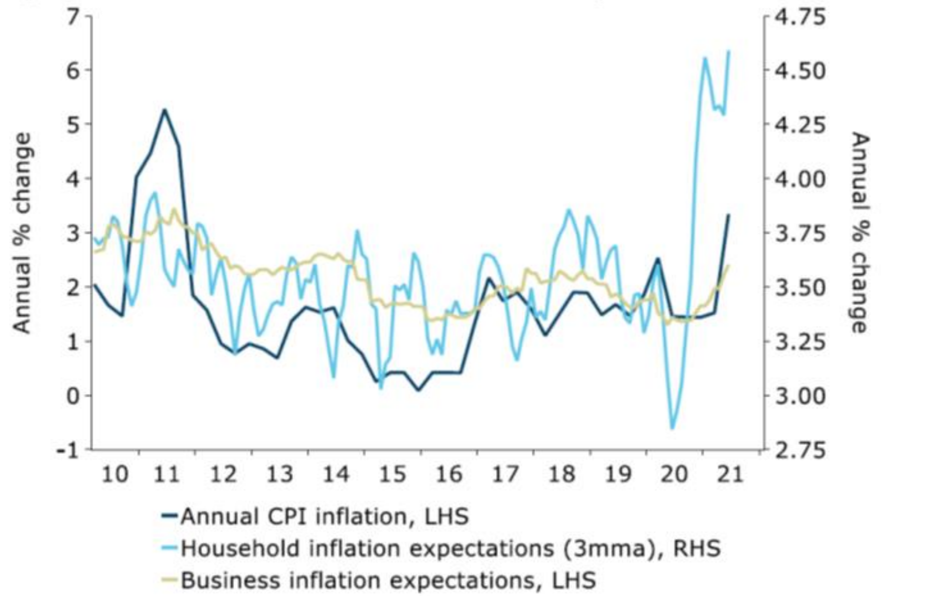
With New Zealand's economic recovery well established and global growth on steroids, focus has shifted to rising costs and inflation. The big question is whether the surge in commodity, freight, construction, and a range of other costs seen this year will be temporary or permanent. Survey measures of business and households suggests that risks point to the latter, with inflation expectation measures running at multi-year highs (see Figure).

In this environment it is unsurprising that central banks have begun to change their tune. No central banker wants to win the economic battle with Covid only to fight an inflationary war. In the US, a number of senior officials at the Federal Reserve have begun to call for an explicit timeframe for rising rates. In its May update the RBNZ signalled that it will lift interest rates from mid next year if the economy and inflation continue to run ahead of expectations. Some economists now expect an increase as soon as August this year. In this respect the RBNZ is leading the pack – rates are expected to lift here ahead of other major economies.

While the direction of interest rates is up, the lockdowns in parts of Australia are a reminder that we are not out of the woods yet. Regardless, the balance between risk and reward for bonds remains poor and one or two small increases in short-term rates is unlikely to change this. We need to see a large increase in rates to make bonds attractive again.

CPI inflation and inflation expectations are running high



Source: ANZ Research

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