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

IWIinvestor Investment Report:

Economic & Market Commentary, Quarter End – September 2020

Overview

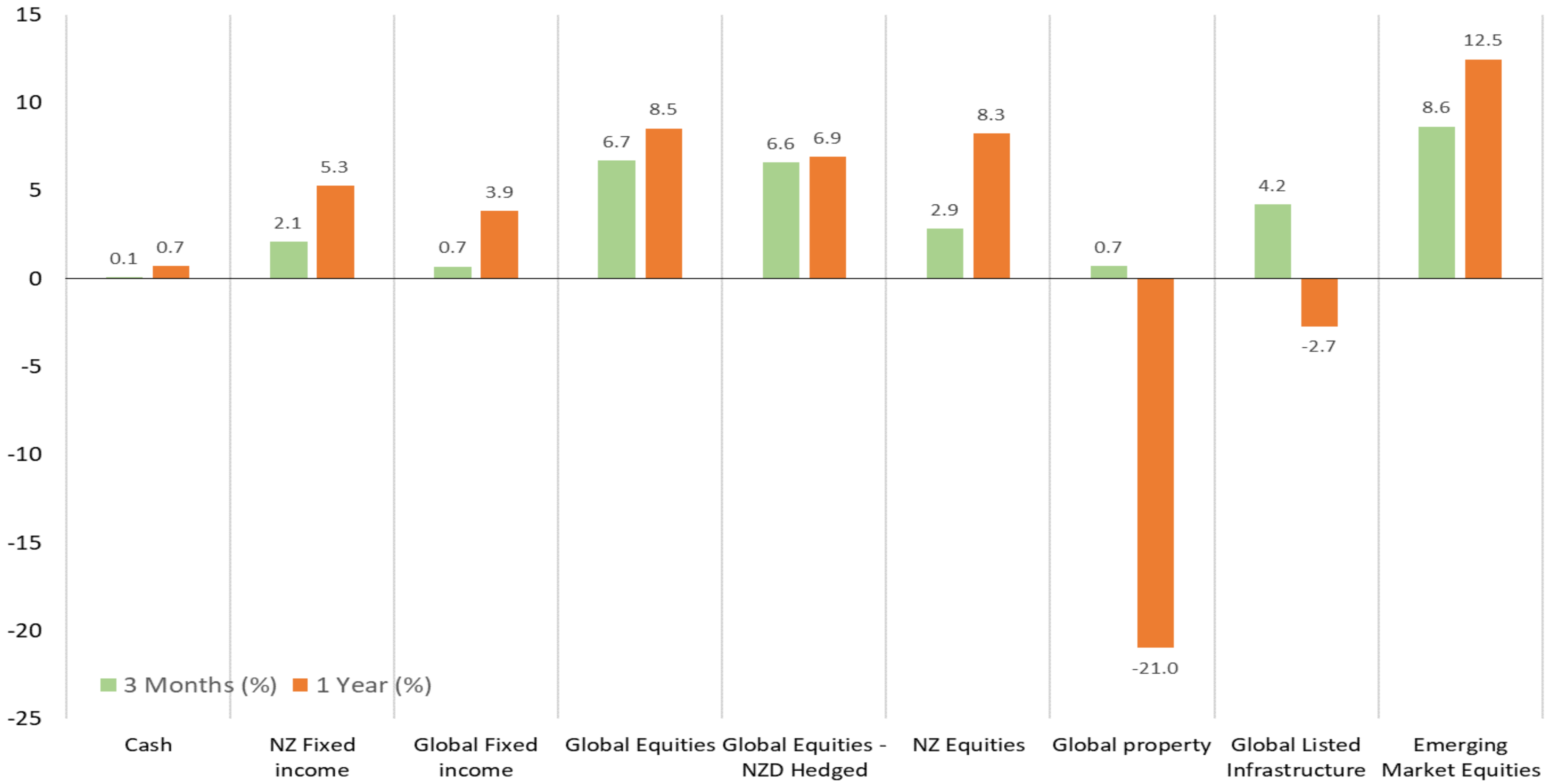
8.1% p.a.	3.5%	0.8%	8.6%	0.1%	15	3
Balanced model portfolio 5-year return	Balanced model portfolio quarterly return	Balanced model portfolio 3-year excess return	Best performing asset Class: (Emerging markets)	Worst performing asset class: NZ cash	Number of funds on the APL	Funds on watch

Key discussion points

- Markets continued to climb over the September quarter, in line with our view in the June that the environment, on balance, favoured risk assets.
- There was a continuation of the same theme from last quarter: the disconnect between value and growth companies continues to widen and recovery remains a tale of two halves within equities. Large cap growth and tech stocks enjoyed another strong month adding to their stellar annual return. Small caps, value stocks, and non-US stock markets in general (excepting NZ) have under-performed over the year, despite showing some solid performances over the past few months.
- Note, recent fund additions of Simplicity NZ Share, Dimensional Australian Sustainability Trust, and Kernel Global Infrastructure have not been included in this report, however we will pass on the fund dashboards for these funds and our research reports.

Financial Market Update

The market rally continued during the 3rd quarter with emerging markets the top-performing asset class



The chart shows asset class returns in local currency, i.e. for a 'global' investor except for Infrastructure and Property which are in USD. The returns experienced by your portfolio may differ from this depending on movements in the NZD and the amount of currency hedging of that asset class.
Source: Morningstar Direct

Market Commentary

The September quarter added to June's gains

The market rebound continued

Markets continued to climb over the September quarter, in line with our view in the June update that the environment, on balance, favoured risk assets. Better than expected macro and corporate earnings data, massive fiscal and monetary policy support, and the search for yielding assets out-weighed concerns around economic risks and re-surging Covid cases in Europe and the US.

- **International shares** rose around mid-single digits in the quarter with NZD hedged shares slightly higher. These results were sufficient to completely erase the Covid-19 losses earlier in the year – the very broad MSCI All Country World Index has reached new highs (Figure 1 over page).
- **Trans-Tasman equity** markets had mixed fortunes. NZ shares performed well but Australian shares were flat in AUD terms, and marginally up in NZD terms. Over the year Australian shares have under-performed, with the ASX 200 Index still around 18% lower than the peak level it reached in February 2020.
- **International property** stocks rose were largely flat in the quarter, and are still down around 17% year-to-date, reflecting ongoing uncertainty around how much lower longer-term tenancy demand may be in the post-Covid world. International infrastructure has been more resilient, with returns only slightly down over the past year.
- **Fixed income** returns were also positive over the quarter. New Zealand investment grade (IG) bonds returned around 1.7% in the quarter and 5.5% over the year to September, while global IG bonds returned around 4% over the year. Both are materially higher than the return to cash over the period. However, running yields are now very low, at around 1% for global IG bonds and just 0.5% for New Zealand IG bonds. This implies returns from fixed income are likely to be much lower going forward.

A tale of two Covids

With some markets now back at all-time highs, questions around whether market levels can be justified have not gone away. Outside of listed markets, similar questions are being raised about the resurgence in residential property market prices. How can asset prices be rising in an environment where overall economic activity and employment remains weak, and many businesses remain heavily reliant on policy support? In our last update we pointed to the following factors, which remain relevant:

- The fact the short-term economic data has been stronger than expected. In the US, the data surprises are the largest ever recorded (Figure 2). In New Zealand, the most recent ANZ Survey of business confidence (Figure 3) suggest businesses are now net positive about their own activity outlook and investment intentions.
- The extremely supportive monetary and fiscal policy settings in place globally, which is instrumental in supporting lending, credit markets and asset prices.

- The fact that despite the rally, risky assets continue to offer materially higher yields than investment grade bond yields and cash yields, plus the prospect of capital gains over the longer run.
- Global mass production of Covid-19 vaccines will likely begin within a short (3-6 month) horizon. China and Russia have leap-frogged this process and have begun rolling out vaccines to parts of their population most at risk (e.g. frontline healthcare workers).

It is though a “tale of two Covids”. The business sector in general has been surprisingly resilient to lock downs. But businesses in sectors which depend on foreign tourists and in-person patronage (e.g. hotels and restaurants) have suffered, as have workers in these sectors, who also tend to be younger and on lower incomes.

The September quarter was very strong

Covid-19 has hence exacerbated further the home ownership and wealth gap between the haves and have nots. Such levels of inequality undermine notions of fairness, social mobility, and economic growth itself. This gap, and mounting government debt levels, mean that taxes will ultimately need to rise, as will efforts to re-distribute wealth and provide better standards of living for the less well off.

The modest tinkering of labour income tax rates that the Labour Party has promised is, in our view, a sign of much larger changes to come. The resounding election victory by Labour itself gives them a powerful mandate to enact their policies without needing to garner support from coalition partners. We expect this to be supportive of economic growth, presenting upside risk to inflation and interest rate settings over the medium-term.

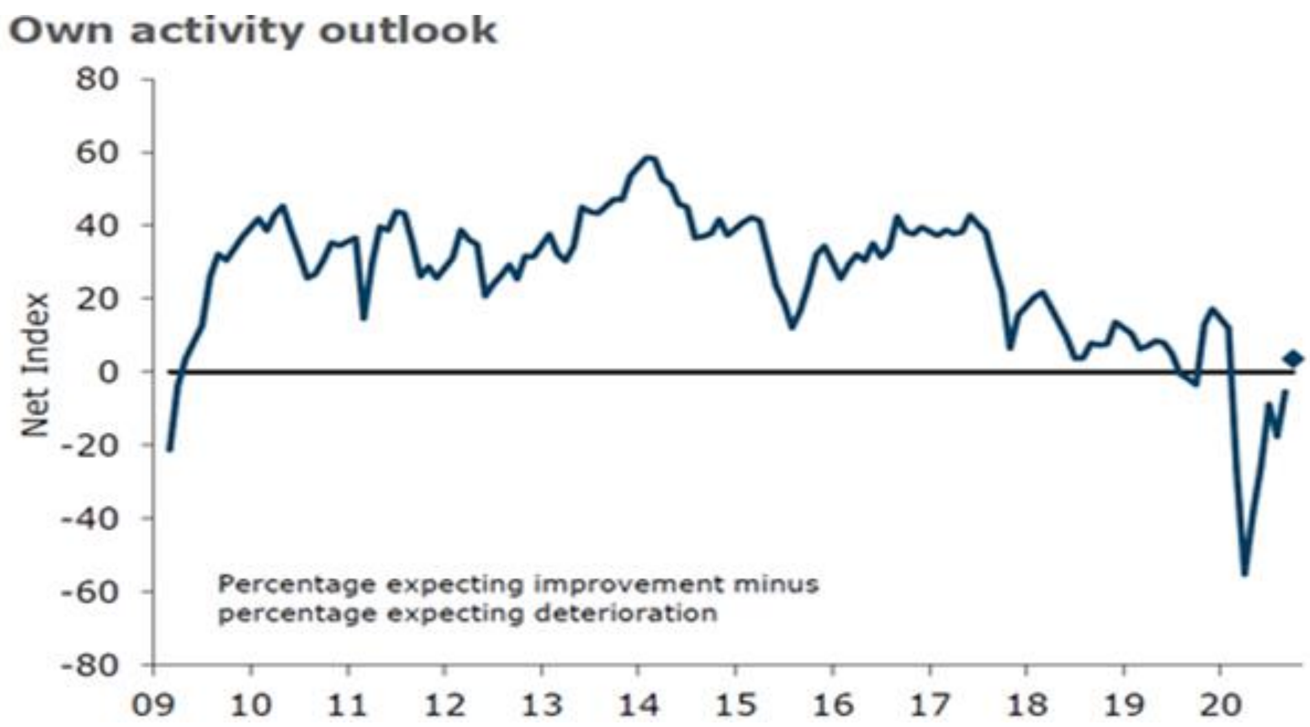
Fig 1: Global Equities reach new peaks

Source: MSCI

Fig 2: US economic bounce back surprise largest on record

Source Citigroup, Yardeni Research

Fig 3: NZ business confidence back in black



Source: ANZ

Disclosure:

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