ADVISER WRAP

November 2018

ANZ Investments brings you this summary of investment markets covering the month of November 2018. Please contact your Business Development Manager if you have any questions or need further information.

MARKET REVIEW

Global markets

Despite some volatility, global share markets staged a late-month rally, allowing them to finish November in positive territory. The MSCI World Index finished 1.2% higher, largely on the back of a recovery in US shares.

A number of factors combined to keep investors on edge, including the US mid-term elections. The Democrats dealt President Trump a blow by taking over control of the House, although the Republicans held on to the Senate. Losing control of the House potentially makes it harder for President Trump to enact his agenda.

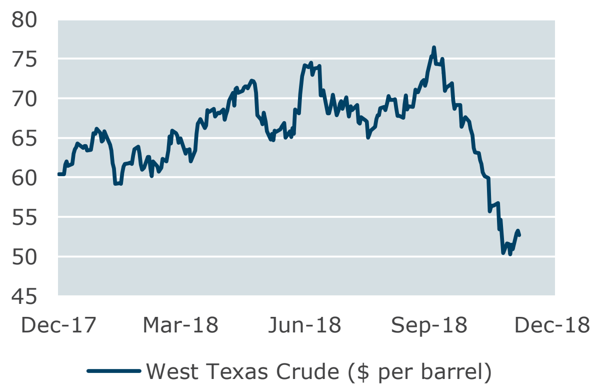
Trade concerns continued to simmer in the background. Tensions were building in the lead-up to the G20 Summit in Argentina, where President Trump was also set to meet Chinese leader, Xi Jingping. In the event, their meeting had a positive outcome; they announced a 90-day truce on further tariffs and China agreed to negotiate future trade terms with the US in order to avoid a new round of tariffs.

In Europe – and with less than four months to go until the UK and the European Union (EU) part ways – the UK's prime minster, Theresa May, announced a Brexit deal. It was later agreed on by the other 27 members of the EU, although it still has to be passed by the UK parliament on 11 December.

In the US, the Federal Reserve (US Fed) Chairman, Jerome Powell, appeared to do an about-turn as he suggested that interest rates in the US were nearing a 'neutral' level. This followed comments a few months ago where he'd suggested they were 'some way off' that level – comments that were partly to blame for the sell-off in share markets in early October. Share markets took the news well, surging higher over the last few days of the month.

The price of oil fell sharply in November, as recent geopolitical tensions eased and supply greatly increased. During the month, oil prices hit a new low for the year, falling to $50 a barrel.

Oil price hit $US50 a barrel



Oil prices have slumped to year lows, on weaker global growth and increased supply. Source: Bloomberg

Against this backdrop, most major global bond markets gained ground in November. Bonds tend to benefit from being a 'safe haven' in times of volatility. The yield on the US 10-year government bond fell by 15 basis points over the month to finish at 2.99%. Meanwhile, the New Zealand dollar strengthened, despite the volatility in financial markets. The kiwi dollar rose 3.8% over the month on a trade-weighted basis.

New Zealand market

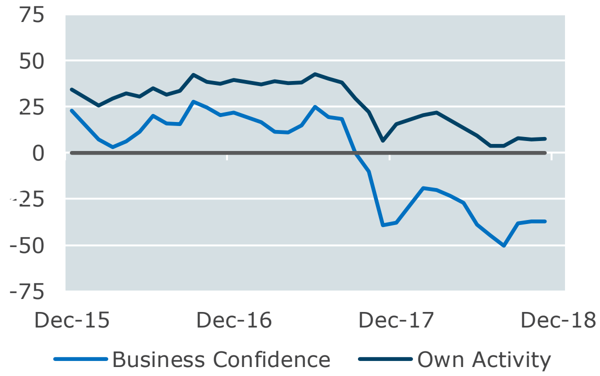
New Zealand shares took their lead from overseas share markets, with the NZX 50 Index up 0.8% over the month.

ANZ INVESTMENTS

New Zealand business confidence appears to be in a holding pattern. A net 37 of respondents in November's ANZ Business Outlook Survey expect general business conditions to deteriorate in the year ahead, unchanged from last month.

Firms' views of their own activity (which historically has been more strongly correlated with actual economic performance) remained positive, and is up 1 point to a net 8%.

Business confidence in a holding pattern



Headline business confidence was unchanged, although firms' views of their own activity has picked up slightly. Source: Bloomberg

However, other surveys suggested a slightly better outlook for business. BNZ's BusinessNZ Performance of Services Index rose for a second consecutive time and is now up above its long-term average. Employment measures picked up also, but this does beg the question how quickly jobs will be able to be filled going forward. This comes as Statistics New Zealand showed that the unemployment rate fell to a 10-year low, of 3.9%, in the third quarter of this year.

It was little surprise then that the Reserve Bank of New Zealand (RBNZ) left New Zealand's Official Cash Rate (OCR) on hold following its meeting in November. Although the Governor reiterated that interest rates could go 'up or down', that specific wording was removed from its statement. While core inflation has picked up, it remains below the RBNZ's 2% mid-point target, suggesting that a supportive monetary policy stance needs to remain in place for now.

Against a mixed economic backdrop, the yield on the New Zealand 10-year government bond rose by 2 basis points to finish the month at 2.56%, although this did hide a big move in yields during the month.

SECTOR REVIEW

International shares

- The MSCI All Country World Index rose 1.2% in local currency terms in November.
- At one point during the month, share markets in most major regions had given back a large part of this year's gains. But the rally late in the month meant the S&P 500 Index finished back at levels last seen in July.
- Market volatility remained at elevated levels, although down from recent highs. The VIX Index, which measures daily volatility, rose from 12 (prior to October's sell off) to a high of 23, only to fall back to around 19 by the end of November. This is well below levels seen in February this year (when it hit 37).

Volatility remains at elevated levels

While volatility is high, it's well below the levels seen in January and February this year, when markets went through a similar wobble. Source: Bloomberg

- US share markets were among the better performers this month. The S&P 500 Index was up 1.8% and the Dow Jones was up 1.7%. Technology shares bore the brunt of the selling, with the NASDAQ Index down 0.3%.
- UK and European share markets were the worst performers, given Brexit concerns.

International fixed interest

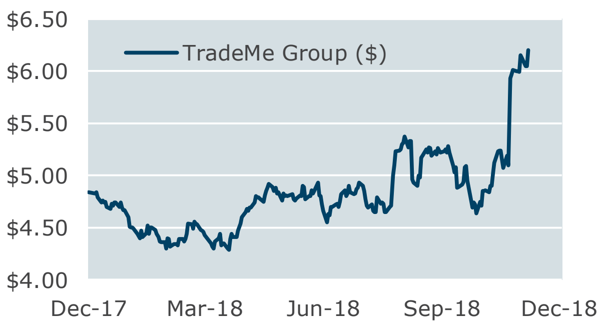
- Against a backdrop of share market volatility, most major global bond markets gained ground in November in total return terms.
- A statement from the US Fed suggesting interest rates were closer to 'neutral' gave bond markets a boost, as interest rates may not need to rise by as much as feared.
- UK and European bonds were also good performers, as the ongoing Brexit uncertainties and falling local share markets meant safe-haven bonds were in favour with investors.

- The yield on the US government 10-year bond rose to a recent high of 3.23%, but fell sharply towards the end of the month.
- Italian 10-year bond yields spiked up as high as 3.60%, as the EU rejected the country's expansionary budget. However, they later dropped by 40 basis points, as investors shrugged it off and focused on the possibility of a compromise between the two sides.
- Corporate bonds underperformed government bonds, given the 'risk off' environment.

Australasian shares

- The New Zealand share market delivered a modest gain, with the NZX 50 Index up 0.8%. The best-performing sectors were Utilities, Communication Services and Consumer Discretionary. The worst performers were Materials, Information Technology and Energy.
- TradeMe Group (+26.4%) and Air New Zealand (+10.0%) were the two top-performing stocks. TradeMe surged on a takeover bid, while Air New Zealand rose on falling oil prices and a stronger kiwi dollar.

TradeMe Group jumps on takeover bid



Its shares were the standout this month, having jumped over 25% on a takeover offer. Source: Bloomberg

- Fletcher Building (-21.2%) was the worst performer, disappointing investors when it announced profits at the lower end of its previous guidance.
- Australian shares were among the worst performers on the global stage, with the ASX 200 Index falling 2.8%. Trade-related issues and falling oil prices were largely to blame.
- The Energy sector (-10.4%) was the worst performer, followed by Consumer Discretionary (-5.1%) and Materials (-4.9%). Information Technology (+0.9%) was the only sector to deliver a positive return.

New Zealand fixed interest

- A 2-basis-point increase in the New Zealand government 10-year bond yield to 2.56% masked a more dramatic move mid-month.
- Yields initially rose as high as 2.80%. This was on the back of strong employment data, which appeared to take the prospect of interest rate cuts from the RBNZ 'off the table'. They later fell, taking their lead from overseas bond markets, as the US Fed suggested interest rates there were closer to 'neutral'.
- As expected, the RBNZ left the OCR on hold following its November meeting. Its statement said it will "keep the OCR at an expansionary level for a considerable period to contribute to maximising sustainable employment, and maintaining low and stable inflation".
- Government bonds (+0.0%) only slightly outperformed corporate bonds (-0.1%), as the latter struggled given investors' risk aversion.

International property

- There were mixed performances from the major international listed property markets.
- The US market was a strong performer, with all of the major sub-sectors delivering positive returns. Listed property markets tend to do well in times of volatility thanks to their defensive characteristics, while declining global bond yields also helped over the month.
- It was a similar story in Asia, with the Japanese market a notable stronger performer.
- However, the European and UK property markets declined on the back of the weaker performance from their broader share markets and ongoing Brexit uncertainties.

Australasian property

- New Zealand listed property market delivered strong gains, as the sector rose 4.0% over the month, comfortably outperforming the broader New Zealand share market, which rose 0.8%.
- The sector has demonstrated its resilience in the face of ongoing share market volatility – and is favoured due to its defensive properties and the steady cash flows available from the market (derived from rental incomes).
- Nine out of the 11 companies that make up the index rose in value over the month. The best performers were Argosy (+8.4%) and Kiwi Property Group (+5.3%).
- The Australian property sector did not fare as well, falling 0.4%, but still outperformed the broader Australian share market.

OUTLOOK

In November, financial markets moved to more appropriately 'price in' our base case scenario of slower global economic growth and tighter financial conditions. We expect higher levels of volatility going forward, and wider credit spreads, but nothing that will tip corporate earnings growth rates into negative territory.

Global share markets now represent better value. Fundamentals continue to support a reasonable outcome for equities relative to bonds and so we continue to bias our portfolios in this direction for now. However, we are wary that the business cycle is maturing and, as interest rates and wages rise, earnings growth will weaken. As a result, we can justify holding only a modest overweight to international shares within our diversified portfolios at present.

Our key observations are:

Monetary policy will become a headwind

The US Fed continues to communicate a gradual path of monetary tightening and a reduction in its balance sheet. US economic data has been stronger than in Europe and Japan, which has resulted in the US Fed being much further along the path to normalise interest rates.

European data, including higher inflation, strong labour markets and a solid growth outlook, reinforce the message that the European Central Bank is preparing to scale back monetary support by halting asset purchases at the end of 2018. Meanwhile, the Bank of Japan has indicated it will allow a wider range around its 10-year yield target and is slowing its asset purchases. In our view, these factors will see global bond yields rise, particularly in Europe and Japan.

China and emerging markets offer value

While China's economy continues to slow from high levels, we expect the slowdown to be well managed by Chinese authorities, who will continue to use targeted stimulus to support the domestic economy. Meanwhile, emerging markets have started to stabilise, despite the increased volatility in developed markets. As a result, we have tilted our portfolios to take advantage of the attractive valuations in the region.

Geopolitical risks elevated, but priced-in

Trade tensions between the US and China have been disrupting economic activity. However, bilateral trade agreements with other regions have already been negotiated and Donald Trump appears to have been successful at using this to strengthen his position at the negotiating table with China. The recently announced 90-day truce between these two countries appears to have been accompanied by a fall in the associated risk premium that was weighing on markets.

Listed property provides defensive qualities

Listed property has outperformed share markets recently, underscoring the defensive nature of this asset class. Earnings remain consistent and fundamentals are still supportive for the sector, with low vacancy rates in good locations and the demand for good quality assets remaining high.

New Zealand monetary policy an outlier

In New Zealand, business confidence continues to stabilise, although the headwinds facing the economy remain. Over the medium term, the New Zealand dollar remains under pressure from widening interest rate differentials with the US, a softening in New Zealand commodity prices, and rising global trade tensions.

The RBNZ has highlighted these factors (along with a slowing in residential house prices and an easing in net migration) as key risks to the local economy. We believe the RBNZ will remain on hold through 2019 and, as a result, New Zealand's current monetary policy stance remains an outlier relative to the rest of the world.

In Australia, equities are still reasonably valued. A solid pipeline of infrastructure projects should continue to support the economy. We expect the labour market to continue to tighten, with wages rising. This should help to support retail sales and consumer confidence. However, signs of a softening housing market in Australia's major cities are a risk; we are closely monitoring the impact this could have on consumer spending, confidence and the RBA's interest rate track.

Key risks

We see the main risks as coming from:

- rising wages without a corresponding improvement in productivity
- a rise in trade tensions
- higher global interest rates
- a faster-than-expected slowdown in Chinese growth, and
- in New Zealand and Australia, high household debt, weaker house prices and rising inflation.

ASSET ALLOCATION STRATEGY

- We expect global growth to remain at or above trend. While US company earnings have been strong on the back of tax reforms, there are signs that earnings growth has peaked.
- Financial conditions remain accommodative; although interest rates are moving higher, they are being raised only gradually.

International shares

Maintain OVERWEIGHT

- We expect international equities to perform well, with trend economic and earnings momentum.
- Global financial conditions remain supportive, and central banks should tighten monetary policy only gradually.
- The strength of the US economy continues to provide support for earnings growth in the US over the medium term.
- Some risks remain; these include any escalation in the trade war between the US and China, weaker economic and earnings data, and a move to a higher interest rate environment.

Australasian shares

Maintain NEUTRAL

- New Zealand and Australian equities can continue to perform well and offer an attractive yield.
- Australia looks more attractive than New Zealand, both in terms of valuations and earnings. However, its banking sector remains a concern while under investigation from the royal commission into financial services, as does its falling housing market.
- The New Zealand market is less-attractively valued and faces lower earnings growth, subdued business confidence, capacity constraints and rising cost pressures.

International property

Maintain OVERWEIGHT

- International real estate markets have underperformed this year, as higher global interest rates have weighed negatively on the sector.
- We believe this divergence has been overdone and, as interest rates start to peak, this asset class should perform reasonably well.
- International property provides our diversified portfolios with defensive characteristics and steady earnings.
- Furthermore, global real estate can perform well in a higher inflation environment.

Australasian property

Maintain NEUTRAL

- The New Zealand and Australian listed property markets have consolidated after a period of strong performance, and the asset class now appears fairly valued.
- The sector can continue to deliver good results in a gradual, rising global interest rate environment, providing our diversified portfolios with stable cash flows and an attractive dividend yield.

International fixed interest Maintain UNDERWEIGHT	▼	• Throughout 2018, as monetary policy support was withdrawn by the US Fed, US bond yields rose, whereas yields elsewhere remained anchored. We believe that US bond yields are now closer to fair value, and we expect yields in other countries to start rising as the world's other key central banks similarly begin to withdraw their monetary policy support. • Corporate bonds are expensive on a risk-adjusted basis and, while they provide a premium, we would expect them to struggle as leverage increases and the investment cycle matures.
New Zealand fixed interest Maintain UNDERWEIGHT	▼	• New Zealand bond yields have been well anchored this year, while global bond yields have moved higher. We believe this divergence has been overdone, and should revert back to more normal levels over time. • We expect the New Zealand economy to hold up fairly well relative to market expectations. In this situation, New Zealand yields should gradually rise, closing the gap between New Zealand and US bond yields.
NZD Maintain NEUTRAL	–	• The New Zealand dollar has improved recently as stable economic data has alleviated some fears over a slowing down in the local economy. • Over the medium term, we expect a weaker New Zealand dollar as growth slows in the local economy and interest rates remain at historical lows. • Our view is moderated by global factors, such as an easing in global trade tensions and moderating US dollar strength.
Cash Maintain NEUTRAL	–	• Cash is held in portfolios to maintain an appropriate level of duration in the defensive/income-oriented portion of portfolios. • It is also used to provide liquidity to facilitate asset allocation in other asset classes.

As at 30 November 2018. Note: equities, fixed interest and currency hedging are managed relative to benchmark, with cash the balancing asset class.

AT A GLANCE – AS AT 30 NOVEMBER 2018

SHARE MARKETS

	Index Level	Performance – local 1mth	3mth	1yr	Performance – NZD 1mth	3mth	1yr
MSCI All Country World Index	574.5	1.2%	-5.6%	-1.1%	-3.9%	-9.6%	-3.3%
MSCI Emerging Markets	54,947.1	2.9%	-6.5%	-7.6%	-1.3%	-9.2%	-11.8%
NZX 50 Index (New Zealand)	8,823.5	0.8%	-5.3%	7.8%	0.8%	-5.3%	7.8%
ASX 200 (Australia)	5,667.2	-2.8%	-10.3%	-5.1%	-4.9%	-12.3%	-9.0%
S&P 500 (US)	2,760.2	1.8%	-4.9%	4.3%	-3.5%	-8.3%	3.6%
NASDAQ 100 (US Technology)	6,949.0	-0.3%	-9.2%	9.2%	-5.4%	-12.5%	8.5%
Euro Stoxx 50 (Eurozone)	3,173.1	-0.8%	-6.5%	-11.1%	-6.0%	-12.2%	-16.1%
Nikkei 225 (Japan)	22,351.1	2.0%	-2.2%	-1.6%	-3.8%	-7.9%	-3.1%
FTSE 100 (UK)	6,980.2	-2.1%	-6.1%	-4.7%	-7.3%	-11.0%	-10.8%
Shanghai Composite (China)	2,588.2	-0.6%	-5.0%	-22.0%	-5.6%	-10.3%	-26.5%

CURRENCIES

	Rate v NZD	1mth ago	3mths ago	1yr ago	NZD Performance* 1mth	3mth	1yr
Australian dollar	0.942	0.921	0.921	0.903	2.2%	2.3%	4.3%
US dollar	0.687	0.652	0.662	0.683	5.4%	3.8%	0.6%
Euro	0.608	0.576	0.571	0.574	5.5%	6.5%	5.9%
UK pound	0.539	0.511	0.511	0.505	5.7%	5.6%	6.8%
Japanese yen	78.017	73.596	73.535	76.876	6.0%	6.1%	1.5%
Chinese renminbi	4.787	4.546	4.522	4.512	5.3%	5.9%	6.1%

* Positive number means NZD has risen

COMMODITIES

	USD price	1mth ago	3mths ago	1yr ago	NZD Performance 1mth	3mth	1yr
Oil	50.93	65.31	69.80	57.40	-26.0%	-29.7%	-11.6%
Gold	1,220.2	1,215.0	1,201.6	1,273.2	-4.7%	-2.2%	-4.5%
CRB Index	181.74	190.97	192.96	189.17	-9.7%	-9.3%	-4.3%

INTEREST RATES

	Official Cash Rate % Latest rate	1mth ago	1yr ago	3mth Deposit Rate % Latest rate	1mth ago	1yr ago	10yr Govt Bond Yield % Latest rate	1mth ago	1yr ago
New Zealand	1.75	1.75	1.75	2.26	2.52	2.38	2.56	2.54	2.72
Australia	1.50	1.50	1.50	2.01	2.10	1.75	2.59	2.63	2.50
US	2.25	2.25	1.25	2.74	2.56	1.49	2.99	3.14	2.41
Euro	-0.50	-0.46	-0.44	-0.32	-0.32	-0.33	0.31	0.39	0.37
UK	0.75	0.75	0.50	0.89	0.82	0.52	1.36	1.44	1.33
Japan**	-0.07	-0.07	-0.06	-0.12	-0.09	-0.02	0.09	0.13	0.04
China	1.62	1.62	1.62	1.10	1.10	1.10	3.38	3.54	3.92

** Changed from target to actual

NEW ZEALAND BONDS

	Total returns 1mth	3mth	12mth
Government	0.0%	0.3%	3.9%
Corporate A	-0.1%	0.4%	3.8%
Corp Inv Grade	-0.1%	0.4%	3.9%
Call Deposits	0.1%	0.4%	1.8%
90D Bank Bills	0.1%	0.5%	1.9%

GLOBAL GOVT BONDS (7-10YR)

	Total returns 1mth	3mth	12mth
US	1.4%	-0.3%	-1.6%
Eurozone	0.8%	0.5%	-0.4%
Japan	0.4%	0.4%	0.1%
UK	0.8%	1.1%	2.0%
Australia	0.5%	0.2%	2.2%

Source: Bloomberg

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