

Monthly View

August 2018

Despite the recent escalation in trade tensions, markets in July posted solid gains (the US sharemarket in particular), supported by strong economic data and positive corporate earnings. US tax cuts, low unemployment and years of accommodative monetary policy (low interest rates and asset purchasing by central banks) has underpinned an extended global economic expansion and solid corporate earnings growth remains encouraging for investor and business confidence.

Markets are concerned about global trade as US tariffs on \$34 billion worth of Chinese goods imports took effect on 6 July. China's government retaliated by imposing tariffs on US\$34 billion worth of US goods imports, mainly agricultural and auto. At the extreme, Trump has threatened to impose tariffs on all US imports from China (which totalled US\$523 billion in the year to May 2018). However, on a more encouraging note, in late July the European Union and the US agreed not to implement additional tariffs on bilateral trade during trade negotiations.

The S&P 500 US share index gained an impressive 3.6% over July. Performance of the 'FAANG' stocks (Facebook, Apple, Amazon, Netflix and Google's parent, Alphabet) were widely divergent. Apple was the first company in history to reach \$1 trillion in market capitalisation as it reported solid revenue growth and higher profits (revenues rose by 17% compared with the same period in 2017 and profits were 32% higher). Microsoft, the world's biggest software firm, reached \$100bn in annual revenue for the first time. Alphabet shrugged off the \$5bn fine recently imposed on it by the European regulator and posted strong results. Amazon also announced a record quarterly profit.

However, there were some large share price falls for giant tech companies, Facebook, Netflix and Twitter, which didn't meet expectations for growth. Facebook had a particularly dramatic drop with a share price decline of over 20% following downbeat guidance about future growth and margins. The events are an important reminder that the tech giants are not immune to changing investor sentiment and their spectacular historic performance is not necessarily an indication for the future.

Over July, other key indices such as the MSCI World Index (+3.0%), the Australian ASX200 Accumulation Index (+1.4%), and the UK FTSE100 TR Index (+1.5%), all posted gains in local currency terms.

New Zealand economic indicators over the past month were mixed. Modest inflation pressure (annual CPI inflation at 1.5% for Q2) and

ongoing strength in the labour market (annual employment growth of 3.7% for Q2) can be viewed from a positive perspective, however, ongoing weakness in business confidence (down to around 10-year lows according to the latest ANZ survey) is a potential concern. We recommend that investors maintain a good balance of global and Trans-Tasman equity exposure in their portfolios.

The local sharemarket rose a solid 3% in June and the momentum continued into early July. However, the sharemarket did give up those early gains by month end, with the NZX50 Gross index posted a 0.2% fall for July. Large-caps underperformed the Mid-caps with strength in Telecoms, Real Estate and IT. Top performers for the month included EBOS Group (+12.5%), Kathmandu (+5.8%), and Vital Healthcare (+5.2%), whilst A2 Milk (-8.7%), Tourism Holdings (-8.3%) and Fonterra Shareholders' Fund (-5.9%) performed the worst. The largest negative contribution to the index was A2 Milk which detracted (-0.8%) to the index for the month.

Meanwhile, official interest rates are expected to remain on hold in New Zealand and Australia for the short to medium term. USD strength has been a key theme in currency markets since April, but the greenback softened modestly against the NZD, euro, pound and Australian dollars in July. The NZD rose 0.8% against the USD.

Our Current view

In summary, we remain neutral with our view regarding equities. Positive macro indicators and robust US growth will lend support to continued solid strength in corporate earnings. However, tempering this is the potential for US-China trade negotiations to worsen by the end of the year. We will continue to monitor risks associated with inflation and deteriorating global trade carefully to consider investment risk.

We also see New Zealand and Australia as showing signs of being in the mature stage of the economic cycle. We are cautious that Australasian shares are currently at high valuations and we will continue to prefer value stocks. Our respective Reserve Banks continue to indicate a preference for keeping interest rates low for the medium term. Notwithstanding this, we continue to keep fixed interest securities at a short duration as long-term interest rates may potentially move higher.

Given the extended period of strength from investment markets, it is important that the share exposure levels in clients' portfolios are appropriate for their risk tolerance.

Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Overweight	We are slowly increasing cash levels to reduce some market risk.
Fixed Interest	Underweight	We think long-term interest rates will start to increase so are keeping duration relatively short.
New Zealand Shares	Slightly Underweight	We continue to look for exposure to New Zealand companies with good dividend yields. Valuations still look high and defensive stocks are more attractive in our view.
Australian Shares	Neutral	There are some reasonably priced companies with solid growth prospects.
Global Shares	Overweight	Generally our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered. An increase in cash rates could have an impact on the sector.

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