

Monthly View

December 2018

Sharemarkets had a mixed month in November, with NZ and US indices posting modest gains, while Australian and UK indices fell. US long-term interest rates eased, oil prices plummeted over 20%, while continuing trade tensions and Brexit concerns plagued financial markets through most of the month.

The NZX50 (up 0.8%) clawed back a small portion of its October losses, but it still sits around 5% below its September record high. Trade Me's gain due to a takeover offer kept the market in positive territory, while at the other end of the scale Fletcher Building's share price decline continued. Australian sharemarket weakness was broad based with the Australian All Ords index dipping 2.8%. Energy stocks suffered in particular due to lower energy commodity prices, with the sector benchmark down 10%.

When we look at markets generally, local markets are driven by the large international markets as investors respond to global macro trends (such as trade tensions, political uncertainty, and rising interest rates). Local drivers can also influence our markets, albeit to a lesser extent. Over November NZ economic data was a mix of positive and negative. Retail sales growth over Q3 was weaker than expected. Business confidence was also weak, posing a key risk to the economic growth outlook. However, the retreat in global oil prices combined with a strengthening NZD means consumers have more money for discretionary spending. Also, the New Zealand Terms of Trade (the prices of our exports relative to our imports) remain high and is a major support to the NZ outlook. When we consider these factors we view that the NZ economy has an equal balance of headwinds and tailwinds. We have a 'neutral' NZ outlook and we are keeping client's portfolio exposure to NZ markets in line with their long-term strategic objectives.

Looking at offshore markets, we see the main issues being the US-China trade tensions and the Federal Reserve raising interest rates. Mr Trump suspended his decision to impose higher tariffs, from 10% to 25% on \$200bn of Chinese imports until March 1st, 2019 at the earliest. In the first day of trade in December the trade truce initially had a positive influence on markets, however, a healthy dose of scepticism followed as investors questioned the strength of the truce. The implication for shares markets is that a deterioration of the trade relationship between the super powers will slow economic growth and reduce corporate profits. The recent arrest of Huawei's CFO in Canada for alleged breaches of US sanctions has put additional stress on US-China relations. It is unclear what the extent and effect of the continued tensions will be, however it is likely to continue to introduce volatility in markets. The other major themes for markets are US interest rates set by the Federal Reserve. Share markets jumped as Jerome Powell said he sees current interest rates 'just below' neutral. That proved to be significant because the language Mr. Powell used 6 weeks earlier indicated a view that the Fed funds rate was 'a long way from neutral'.

Investors, reading between the lines, decided it meant interest rates will not rise as fast as previously indicated (a welcome relief for sharemarkets, which typically sell off when interest rates rise). In Europe, the German DAX and the UK's FTSE index of shares declined over November on news that a Brexit deal may not be reached. In sum, the latest moves leave global markets down on year ago levels, with the MSCI index of global shares down 1.7% in USD terms.

In fixed interest markets, the NZ Government bond yields initially rose, then eased over November. Overall yields are slightly higher, with the biggest lift coming for shorter term rates. One of the drivers of the lift came as investors' expectations of RBNZ rate cuts were reduced over the course of the month.

For commodities and forex (foreign exchange), the NZD has lifted 5% against the USD to end the month trading near 69 cents. The Australian dollar was also strong during the month, and lifted against all the major currencies, but declined 2% against the NZD. For oil, a few months ago it was trading around US\$75 a barrel due to Geopolitical concerns (including the impact of US sanctions against Iran), now however, oil prices were down to around US\$50. Cheaper oil is generally good news for consumers around the world whose budgets had been hit by higher fuel prices. It is also good for businesses where fuel costs are important input factors.

Our Current View

For New Zealand, our economy has been supported by the tailwinds of record-high Terms of Trade, low interest rates and strong population growth. Nonetheless, business confidence remains weak and points to an upcoming slowdown in growth led by a fall in business investment. Globally the combination of strong growth and loose financial conditions was highly supportive for equities in 2017. However this year has seen a number of risks emerging that we suspect will persist into 2019. The good news is that we do not see a recession as likely in 2019, rather a period of slower growth. Without a recession, it is unlikely that profits fall. Without profits falling, it is unlikely that we see a sustained equity bear market (where sharemarkets fall more than 20% from their peak).

After the recent sell off in sharemarkets, which was due to concerns companies were expensive when compared to their potential future profits, valuations are now looking more reasonable and are closer to their long-term averages. With revenue growth expected from the latest company announcements in the US, we still prefer global shares over New Zealand shares. Albeit, clients should be at or near their long term-strategic allocation. There has been an increase in global economic activity over the past couple of years, but we believe the longer-term outlook for economic growth remains subdued due to risks with the US - China trade talks and rising US interest rates. In 2019, investors should ensure that their portfolios have a risk exposure consistent with their risk tolerance.

Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Overweight	We have higher cash levels to reduce some market risk.
Fixed Interest	Underweight	We think long-term interest rates may increase so are monitoring duration.
New Zealand Shares	Neutral	We continue to look for exposure to New Zealand companies with good dividend yields. Valuations still look high and defensive stocks are lower risk in our view.
Australian Shares	Neutral	There are some reasonably priced companies with solid growth prospects.
Global Shares	Neutral	Generally our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered.

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