JMI Wealth

Monthly View

December 2021

United States Share Gains Sustained

On a full year basis international shares have generated highly satisfactory returns. The return from the S&P500 over 12 months in NZ$ was +32%. November was a strong month for New Zealand investors in US shares. The S&P500 gained 4.3% in NZ dollar terms with all of the monthly positive gain a result of the US$ appreciating. The index declined 0.7% in local US currency. Currency fluctuation was also the main swing factor in monthly returns from other share markets. The global index (MSCI ACWI) was up 2.6% in NZ$ but declined 2.4% in US$. Currency fluctuation can have a very strong short-term impact but tends to be outweighed by fundamental stock movements longer-term. US company reporting during the month showed very strong earnings growth. Unsurprisingly semi-conductor companies Qualcomm, Nvidia and Broadcom were amongst the best performers in the S&P 500 given chip shortages. International investors responded to the emergence of the Omicron Covid mutation by moving to fixed interest and out of shares at month end.

Resources and Banking Prominent in Australia

Currency movement had a negative impact on the returns from Australian shares. The ASX200 accumulation index fell 0.5% in November but the decline was intensified for New Zealand investors as the kiwi rose resulting in a fall of 1.2%. Financials and energy were the poorest sectors in the Australian market. Westpac was a drag on the financial sector falling 17.7%, with the bank disappointingly reporting a poor net interest margin outlook as the bank competes to restore market share and amid ongoing regulatory compliance issues. Other banks held up better. Energy share declines reflected falls in the oil price. Materials was the best performing sector up 6.3%. Iron ore companies Fortescue (+22.1%) and Mineral Resources (+17.3%) gained as the iron ore price, although still down US$7.50/T for the month, staged a recovery from US$91/T.

New Zealand Share Market Rebasing

Defensive New Zealand shares continued to feel the effects of rising interest rates. The S&P/NZX 50 Gross index was down 2.9% and the NZ real estate index fell further (-3.8%). Apart from the sensitivity of income yield companies to interest rate rises, there were few clear trends. The best performers were Fisher & Paykel Healthcare (FPH) +6.8% and Chorus +5.0%. FPH surprised to the upside in its first half results and continues to have a tailwind from the continuing pandemic although management expect this to moderate in the second half (prior to Omicron gaining a foothold). NZ 'disruptive' companies Pushpay (-28.4%) and Serko (-17.9%) were the poorest performing shares in the index with Westpac also making its presence felt. Pushpay's growth rate may be slipping, leading to a derating of the company. Travel booking company Serko remains unprofitable and conducted a large capital raise at month end. The large retirement village companies Ryman and Summerset were notable negative contributors to the index. In the property sector the negative return can be attributed to rising interest rates and the price to Net Tangible Asset value (NTA) moved to a discount.

Domestic Fixed Interest Stabilises

Fixed interest clawed its way back into the black in November. The positive fixed interest gains occurred even though the Reserve Bank of New Zealand increased the Official Cash Rate to 0.75% and projected further increase to over 2.6% in 2023. The fixed interest market had priced in a higher path for interest rates prior to the RBNZ Monetary Policy Statement and some of this was pulled back after the announcement leading to gains in longer dated bonds.

United States Upward Bias in Fixed Interest Likely

Having NZ already pricing in higher interest rates could see a divergence between future rate rises here and globally. The Federal Reserve has commenced tapering its monetary policy, buying US$15 billion less of US bonds per month and has indicated that it may accelerate this, ceasing buybacks in March or June next year. The reduction in bond buying is likely a precursor to an actual increase in the Federal Funds Rate (NZ equivalent to the Official Cash Rate) if US inflation remains elevated. This is yet to translate to a steep rise in US interest rates. This is a scenario the Federal Reserve will be keen to avoid but the bias in US interest rates is upward. US interest rates are important for investment markets, not only to global fixed interest returns but they also impact longer term New Zealand bonds and share market valuations.

Conclusion

The emergence of Omicron has given markets reason to reassess the immediate outlook and any evaluation of portfolio positioning must be aware of the potential for Covid to continue to disrupt. Given experience to date, existing medical tools and governments responses, the base case is that a normalisation of economic conditions continues but with uncertainty as how quickly this occurs. Returns from New Zealand fixed interest are likely to be modest, but the asset class should revert to providing a defensive buffer for portfolios on the proviso that any further interest rate increases are small and digestible. Keeping the maturity of fixed interest exposure relatively short continues to be prudent. International fixed interest markets are now less synchronised and given the lower prevailing yields we remain cautious. The near-term relative outlook for New Zealand shares looks moderate with the comparative return from dividends against fixed income securities reducing. Australian shares continue to appear to offer more potential in a market with considerably greater depth. The Australian market contains large capitalisation companies that are genuine global leaders. Other share markets similarly offer far greater diversity but sensitivity to inflation looms as a key driver of performance. Ability to preserve margins in a rising cost environment will be a key differentiator unless inflation is quelled rapidly. If inflation is controlled, then past drivers of share values, being consumer demand, earnings growth and high levels of liquidity, will likely reassert themselves.

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Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Underweight	Reduce cash, negligible return
Fixed Interest	Underweight	Rising interest rates negative for the sector. May look to reduce underweight in medium term.
Australasian shares	Overweight	Slight overweight preferring Australian cyclicals
Global Shares	Overweight	Slight overweight relative to strategic asset allocation
Property	Neutral	Monitor exposure to interest sensitive investments

Indices for Key Markets

As at 30 November 2021	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	-2.9	-3.8	-0.4	13.0	13.0
S&P/ASX 200 Accumulation Index (NZD)	-1.2	-2.0	15.0	11.8	10.1
MSCI ACWI Index (NZD)	2.6	1.8	23.6	16.8	15.5
S&P/NZX 90 Day bank bill Total Return	0.1	0.1	0.4	0.9	1.4