JMI Wealth

Monthly View

February 2020

Investors showing resilience to non-economic events

Investor optimism for the year ahead has already been challenged in January by non-economic events. The year commenced with an escalation in hostilities between Iran and the United States. The protagonists were able to calm relations and avoid escalation. Specifically, in Australia the bush fire season has been particularly severe with over 5 million acres burnt. This was subsequently followed by the Coronavirus outbreak in China. This latter threat continues to play out and has disrupted the immediate outlook for financial markets and growth prospects with the extent of further reverberations yet to be determined. Optimistically the epidemic will be controlled and a recovery to pre-Coronavirus levels will follow. A deepening epidemic would require a re-evaluation of our views on markets, but we do not believe that this is necessary at this time. Despite these shocks investor sentiment has remained robust.

Safe havens in favour for now

In response to the risk of further market disruption long-term interest rates have fallen both offshore and in New Zealand. This has been beneficial to the bond component of portfolios as a higher premium is placed on capital preservation. The flight to fixed interest has occurred despite economic growth forecasts remaining positive. Central banks have kept rates at similar levels in January as inflation expectations remain muted and to encourage economic activity. Although inflation is below target long term bond yields are comparatively unattractive and this may lead to the present low yields being a temporary phenomenon. Despite a risk that bond yields recover it is unlikely that yields will rise steeply above pre-Coronavirus levels. That being the case equities will remain relatively attractive.

The New Zealand equity market performed extremely strongly in 2019 with the S&P/NZX 50 Gross index increasing over 30%. Returns at this level are unlikely to be repeated in the current year. Earnings growth is already largely reflected in share valuations. While there are growth exceptions locally, a significant proportion of 2020 returns are likely to be derived from dividend yield. Some sections of the market are subject to identifiable headwinds. New Zealand companies with direct exposure to the Chinese consumer and international travel have already been impacted to a degree by the Coronavirus e.g. Auckland Airport, Tourism Holdings and Air New Zealand. It may take some time for sentiment towards these companies to improve.

In contrast domestically orientated companies are likely to be buoyed by the government's stimulus programme which has been further reinforced by intended additional spending by Kainga Ora, the Crown's housing agency. The additional government spending and further increase in the minimum wage will probably put profitability of businesses under further pressure but will likely support consumer spending. Retail stocks will be a beneficiary of a continuing healthy consumer. Property market supply and demand conditions remain favourable with the possible exception of hotels. This environment is likely to remain supportive of domestic property stocks.

International offering better growth

Global equity markets have been weaker than Australasian markets in January with the S&P 500 flat in local terms with the Chinese markets selling off into the end of the month. Despite this, growth opportunities may be better offshore than locally in the coming year. US technology companies cash generation has been strong in the February reporting period with the revenue growth of Microsoft, Amazon, Google and Apple ranging between 'good and great'. The US consumer remains in good shape and a recession is unlikely as long as this continues.

Our Current View

The key consideration in the immediate outlook is the path that Coronavirus will take. It is unlikely that the outcome will be clear cut in the short-term but optimistically the impact of the virus will be confined in the same manner as previous SARS, MERS and Zika outbreaks. That being the case the negative investor sentiment will likely be temporary in nature although there will be more lasting effects in relation to supply chain logistics and confidence in specific sectors such as travel. Provided that quarantine measures are effective, more normal economic factors will drive investment performance.

Valuation (Price Earnings multiple) expansion has been the primary driver of returns in 2019 as opposed to earnings growth. Valuation multiples are likely to be maintained given still low interest rates, but earnings will need to grow for the current prices to be sustained and lift further. Continuing share market support appears to be a reasonable assumption given modest economic growth, low inflation, low interest rates and continuing easy monetary policies.

Although still supportive to investors a less favourable and more volatile economic climate should be expected over the following year. Active portfolio management will be required to enhance returns.

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Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Overweight	Continuing caution but some selective reallocation to higher returning assets as opportunities arise
Fixed Interest	Underweight	Safe haven status has driven recent returns. Limited scope for further upside.
Australasian Shares	Benchmark	Anticipate ongoing support from yield.
Global Shares	Benchmark	Outlook is improving and represents better relative opportunity.
Property	Overweight	Maintaining overweight position but extent of overweight reduced.

Indices for Key Markets

As at 31 December 2019	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	2.0%	8.6%	30.4%	18.4%	15.3%
S&P/ASX 200 Accumulation Index (NZD)	4.4%	2.1%	22.8%	12.4%	8.6%
MSCI ACWI Index (NZD)	3.1%	4.0%	24.8%	16.4%	11.6%
S&P/NZX 90 Day bank bill Total Return	0.1%	0.3%	1.6%	1.9%	2.3%

Click here to read the Clarity Monthly Fund Commentary.

If you have any questions please contact us on +64 9 308 1450 or visit our website www.jmiwealth.co.nz