JMI Wealth

Monthly View

May 2021

Markets Lift in April

The New Zealand share market enjoyed a positive April with the S&P/NZX 50 Gross index up 1.4%. April's better return was insufficient to offset the declines in the prior two months. Although the domestic market made gains it was again outperformed by the Australian and US markets up 2.2% (ASX 200) and 2.8% (S&P 500) respectively in New Zealand dollar terms.

For New Zealand, the gentailers specifically Mercury Energy, Contact Energy and Trustpower had a strong month up over 5% each after the selloff we saw across the sector in March due to the clean energy ETF selling. Fisher & Paykel Healthcare, while being flat for the last six months, bounced off its lows in March rising 13.30% for April.

Locally fixed income returns were positive for the month with longer dated bond maturities benefiting from interest rates moving lower in April. Similarly returns from international fixed interest were also positive in April with a 1.3% return for the month.

The recovery in fixed income returns in client portfolios followed negative returns from this asset class earlier in the quarter. The negative returns were driven by the outlook for inflation rising and although the market has reduced some of the expectation for future inflation it still remains a concern for investors.

Australian Prospects Advance

New Zealand and Australian investment markets offer differing investment characteristics and recent performance illustrates this. New Zealand has more defensive characteristics with one or two exceptions. Infrastructure/utility and property companies represent a greater proportion of the NZX 50. Now that interest rates appear to have bottomed the tailwind to these types of companies has dropped away. New Zealand's large growth companies are Fisher & Paykel Healthcare and A2 Milk. FPH share price is highly valued at over 40 times earnings. A2 Milk has encountered adverse trading conditions and the company has significantly de-rated culminating in a further profit downgrade. As a result, the New Zealand share market has not been as strong as Australia. In contrast commodities like copper and iron ore have shown price growth and the Australian resources sector has been a beneficiary. Australian banks have come through 2020 in much stronger shape than previously expected. In their recent results bad debt provisions were written back and dividends reinstated. Australian banks at current levels offer attractive yields which look set to continue to improve. Other Australian companies such as gaming and healthcare also appear to be well positioned for the post COVID recovery and are international in the scope of their operations. Consequently, an increased portfolio tilt to Australia is favoured.

Global Inflation

Prices are rising around the globe particularly from a production input perspective. Copper is the highest it has been in 10 years. Iron ore, Brent Crude oil and US lumber future prices have all increased. This has been echoed in New Zealand's soft commodities milk, meat and logs. The increase in commodity prices has been exacerbated by supply bottlenecks.

It is little surprise that inflation expectation surveys are reflecting higher rates of expected inflation. Central banks contend that the inflation currently seen will be temporary. This position is predicated on surplus capacity remaining in economies and is illustrated by levels of unemployment yet to fall to pre-COVID 19 rates. However, offsetting this view is the fiscal stimulus being undertaken on top of massive expansion of the money supply in 2020. The Biden administration has announced three spending proposals, being a US $2.3 trillion American jobs programme, a US$1.9 trillion infrastructure package and a US $1.8 trillion American families plan. The infrastructure plan alone represents 10% of US GDP. Clearly proposed spending at a headline level by the US government is large relative even to the American economy but proposals may be watered down, and actual implementation will be spread over a number of years, eight in the case of the infrastructure proposals.

Although some of the short-term upward pressure in interest rates has relented the underlying economic conditions suggest that a bias to rising rates continues particularly in relation to long-term rates. This upward bias is beginning to be seen locally with a small increases (20-40 bps) in mortgage rates over three years. However, at this stage the risk of a further rapid rise in rates appears contained over the short-term.

Cyclical Companies set to Benefit

The US government spending will potentially occur in conjunction with the US economy normalising. Pent -up demand and the spending of accumulated savings from 2020 will boost GDP and with it the earnings of many companies. This type of effect is already apparent in the recently reported earnings of the FANG companies. Facebook, Amazon and Google reported very strong quarterly results ahead of market expectations but have seen their share prices fall as the expected future levels of growth by investors might be too optimistic. Netflix reported subscriber growth which was below market expectations. Its share price has fallen by approximately 12% since mid April when the share price was $555. Similarly, US banks reported strong profit growth as provisions taken last year were written back and gains were made from security trading.

The economic recovery back drop is usually supportive of cyclical companies. This should see the share prices of companies such as financials and commodity producers continue to improve into year-end as well of those COVID impacted stocks such as airlines and logistics. Rates of vaccination and the extent to which economies reopen will be critical to this scenario and it is likely that there will be set-backs but the trend continues to be supportive. The US and United Kingdom have been very successful in vaccinating their populations, with over 40% of each country's inhabitants receiving two vaccine doses already. Australia and New Zealand trail significantly behind.

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Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Underweight	Reduce cash, negligible return
Fixed Interest	Underweight	Returns expected to be low in short to 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 April 2021	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	1.4	-3.0	20.9	14.7	13.3
S&P/ASX 200 Accumulation Index (NZD)	2.2	8.8	32.5	9.7	10.0
MSCI ACWI Index (NZD)	1.9	10.0	25.5	13.3	13.8
S&P/NZX 90 Day bank bill Total Return	0.0	0.1	0.3	1.3	1.6

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