JMI Wealth

Monthly View

October 2021

New Zealand Shares Eke Out a Small Gain

New Zealand outperformed other share markets with a marginal positive return of +0.4% for the month. The New Zealand dollar weakened into month end which assisted returns from offshore, but with the exception of Japan the monthly returns for most other share markets were negative.

The best returning local companies in the month had been some of the poorer performers in prior months. These companies had specific news flow attached to them. Kathmandu achieved the largest gain (+16.9%) despite lockdowns in New Zealand and Australia. Kathmandu reported strong global surf wear sales which more than offset weakness in traditional outdoor wear. Sanford was up 14.6% as a result of position taking by Nga Tahu investments. Synlait (+12.7%) reported results as well and although the loss was large the company indicated a much-improved outlook which will take time to achieve.

Trustpower (-8.3%), Goodman Property (-6.7%) and Vital Healthcare Property (-6.5%) were the poorest performers. A common theme between these companies was some sensitivity to interest rate increases. The property sector overall made a negative 3.4% return for the month.

Auckland remained in a Covid 19 lockdown for the entire month. The continuing Covid 19 restrictions are reducing national spending. Retail and property investment are being adversely affected by the restrictions although businesses are better prepared than when quarantine was imposed in 2020.

Commodity Price Movements Reflected in Australian shares

Australia underperformed New Zealand for the month, returning -0.9% in NZD terms and -1.9% in AUD terms. Energy was the best performing sector in Australia in September (+16.7%), with Woodside Petroleum up by 22.5% as oil and LNG prices increased on the back of shortages in China and Europe. In contrast Iron Ore producers fell with Fortescue down 20.7% in the month and Mineral Resources close behind at -18.4% for the month. Gold miners similarly exhibited weakness. Australian states of NSW and Victoria were harder hit by Covid 19, but signs of reopening have seen travel companies Flight Centre (+30.8%) and Qantas (+11.4%) appreciate.

Risks Reflected in International Shares

The US market had a poor result in September as the inflation outlook deteriorated, interest rates rose and issues around the US debt ceiling emerged. The S&P 500 index was down nearly 5% for the month. Technology remains susceptible to rising interest rates. Like Australia energy was the best performing sector (+9.5%). The potential for property developer Evergrande to default in China also worsened sentiment with fears that this could be a systemic threat to the Chinese financial sector. Such fears have been largely dismissed but the developer's difficulties continue to have reverberations. The Japanese share market (+4.9% in yen terms) continued to produce strong equity returns as the country completed elections, removing political uncertainty.

Interest Rates Lift

Inflation combined with more buoyant economic conditions is leading to interest rates rising internationally, most notably the US government treasury bonds. Interest rates at present remain below levels reached in March of this year but are producing negative returns for bond investors and causing share investors to reassess company outlooks in a higher interest rate environment together with relative income yield. The Federal Reserve has signalled that it will reduce monetary stimulus but is a long way from actually increasing its Federal Funds Rate.

New Zealand interest rates have also risen post the commencement of the lockdown and the RBNZ has followed through with an increase in the Official Cash Rate on October 6. The RBNZ has indicated that it expects to increase the OCR further over coming months. Longer term interest rates in New Zealand have also been rising.

Conclusion

In addition to the recurring issue of inflation and likely interest rate rises, investors have had numerous other factors to consider in September. These include the implications of the resurgence in Covid 19, rapidly rising energy prices, supply chain congestion, Evergrande implications and a possible US government debt ceiling breach.

Each of these presents challenges and opportunity. With increasing vaccination and the emergence of an antiviral treatment the prospect of normalisation has increased in economies that have increased saving, pent-up demand and improving employment levels. Increasing interest rates at present are symptomatic of this with demand exceeding constrained supply. There will be winners and losers from inflation and rising interest rates, and this will require investors to be aware of the industries and sectors companies are exposed to when making their asset selection. Increasing rates are likely to be positive for financials and companies with pricing power which should be able to preserve margins. Although rising energy prices may hurt GDP growth in China and Europe it is a boon for long depressed petroleum and coal companies. Valuations of non-profit technology companies may be challenged by rising interest rates as higher interest rates may mean lower growth, challenging the expected future earnings of these companies. In contrast, cyclical recovery companies are likely to enjoy further support.

The level of interest rates, although rising, remains low in a historical context. The trade-off between the capital protection characteristics of bonds and the growth characteristics of shares is improving but the balance remains in favour of shares. September's returns are a reset and October has statistically also been a volatile month at times. Despite this a tilt to growth securities continues to be preferred under the current prevailing economic outlook when taking a medium to long-term view.

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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 September 2021	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	0.4	4.9	13.0	12.4	12.5
S&P/ASX 200 Accumulation Index (NZD)	-0.9	-0.8	26.3	8.1	10.3
MSCI ACWI Index (NZD)	-1.9	0.4	23.0	11.7	15.0
S&P/NZX 90 Day bank bill Total Return	0.0	0.1	0.3	1.0	1.4

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